The Economist

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Politics this week

Fighting between forces loyal to **Libya's** leader, Muammar Qaddafi, and his opponents in the east grew fiercer. He remains in control of Tripoli, the capital, and is battling to seize back towns under rebel control. Western and Arab leaders discussed whether a no-fly zone should be imposed. See article

The UN said that the humanitarian situation caused by the fighting was dire, with more than 100,000 refugees from Libya in makeshift camps across the borders with **Egypt** and Tunisia. The UN suspended Libya from the Human Rights Council; the International Criminal Court opened an investigation into possible crimes against humanity committed by Libya's leaders. See article

The Egyptian prime minister, Ahmed Shafiq, stepped down, as did the **Tunisian** prime minister, Mohamed Ghannouchi. Protests continued in both countries, with pro-democracy campaigners complaining about the slow pace of reform and the continuing presence of allies of the former regimes. See article

Demonstrations got angrier in **Yemen's** capital, Sana'a, and in other towns across the country. At least 27 people are reported to have been killed since the protests began a few weeks ago. President Ali Abdullah Saleh's offer to form a unity government failed to quell the unrest. See article

At least one person was killed in protests by jobless and ill-paid youths in Sohar, a port city in hitherto peaceful **Oman**. Days later, however, thousands of Omanis took to the streets in support of Sultan Qaboos, who has promised reform. See article

Mir Hossein Mousavi and Mehdi Karroubi, leaders of the **Iranian** opposition Green Movement, have been thrown in jail, according to their families. Thousands of protesters took to the streets in response, leading, said the opposition, to 200 arrests.

Six men were killed in an apparent assassination or coup attempt in **Congo**. Shooting broke out in Kinshasa, the capital, after unidentified men armed with guns, rocket-propelled grenades and machetes attacked the home of Joseph Kabila, the president.

Religious intolerance

Shahbaz Bhatti, **Pakistan's** minister for minorities, was gunned down outside his home in Islamabad. Mr Bhatti, a Christian, was a critic of Pakistan's harsh blasphemy laws, as was Salman Taseer, the governor of Punjab, who was assassinated two months ago. A message left at the scene of Mr Bhatti's murder promised death to those who offer support to blasphemers. See article

A court in the **Indian** state of Gujarat found 31 Muslim men guilty for the deaths of 59 Hindu activists who died in a fire at a railway station in 2002. The killings at Godhra ignited rioting in which at least 2,000 people, mostly Muslims, were massacred. Eleven of the defendants were sentenced to death.

India's Supreme Court ordered the head of the country's **anti-corruption** commission to resign, because he faces corruption charges.

Get with the programme

The recently retired head of **Bolivia's** drug police was arrested in Panama and sent to the United States to face charges of trafficking cocaine. Three other senior police officers were arrested in Bolivia. In its annual report this week the International Narcotics Control Board, a UN body, complained about the failure of the government of Evo Morales, Bolivia's president, to curb cocaine production. See article

Brazil's government said it would scale back planned spending on housing for the poor, postpone the purchase of 36 fighter jets for the air force and freeze the federal government payroll as part of its effort to cool an overheating economy.

The beginning for Enda

Voters in **Ireland** threw out their Fianna Fail-led government at an election. The new government will be led by Fine Gael's Enda Kenny, whose party scored its best result ever. Mr Kenny has promised to secure a better deal from the European Union on Ireland's bail-out. See article

The **Dutch government** looked set to lose its majority in the upper-house Senate after its coalition partners did badly in regional elections.

France's president, Nicolas Sarkozy, sacked his controversial foreign minister, Michele Alliot-Marie, over her apparently close links with the ousted Tunisian regime. Her job went to a former Gaullist prime minister, Alain Juppe. See article

The **German defence minister**, Karl-Theodor zu Guttenberg, was forced to quit after a long row over plagiarism in his doctoral thesis. Chancellor Angela Merkel, who was reluctant to lose the popular Mr zu Guttenberg, replaced him with a Christian Democrat stalwart, Thomas de Maiziere. See article

Two American air force servicemen were shot dead and two were wounded when a gunman opened fire on a military bus at **Frankfurt Airport**. A suspect, apparently from Kosovo, was arrested.

A Bangladeshi man was found guilty by a court in London of involvement in a plot to blow up **airliners**. Rajib Karim worked as a software engineer for British Airways, where he contacted Anwar al-Awlaki, an American-born radical cleric based in Yemen.

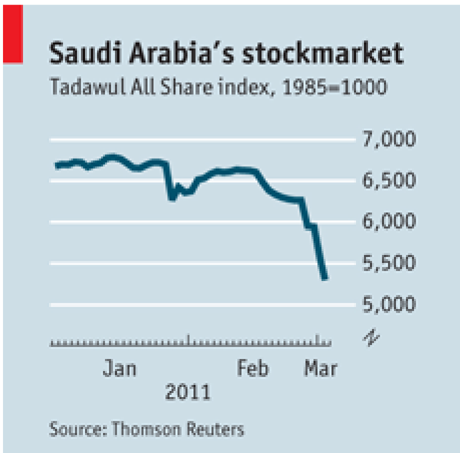
Round and round again

Democrats and Republicans in Congress passed another interim measure that avoids a **shutdown** of the federal government and cuts $4 billion in spending. But the bill provided only a two-week extension to funding, and the whole issue will have to be resolved again by March 18th. See article

Barack Obama suggested that he would give states the opportunity to seek waivers from mandates in the new **health-insurance law** as soon as the legislation comes into effect in 2014. The act that was passed by Congress requires states to wait until 2017 before they can apply for opt-outs.

The **Supreme Court** ruled that the constitution protected the right of a fundamentalist church from Kansas to picket the funerals of troops killed in the Afghanistan and Iraq wars, overturning the decision of a lower court that had sided with the family of a marine who had served in Iraq. The Westboro church believes the wars are God's punishment for America's tolerance of homosexuality. It airs its views near memorial services for the troops, usually under police protection.

Business this week



The continuing instability in the Middle East caused **stockmarkets** in the Gulf region to tumble. Saudi Arabia's main share-price index fell to a 23-month low amid worries about the potential for unrest among the Shia population in the oil-producing east of the country, while the benchmark indices in Dubai and Kuwait hit six-year lows. Meanwhile, the chief economist at the International Energy Agency predicted that "the age of cheap **oil** is over". Brent crude traded at around $115 a barrel. See article

The Obama administration issued the first permit to restart **deepwater drilling** in the Gulf of Mexico since the lifting in October of a moratorium that was imposed after the BP oil-spill disaster. With the oil price so high, the government has come under pressure to allow more offshore drilling.

In his twice-yearly report to Congress **Ben Bernanke**, the chairman of the Federal Reserve, gave warning that surging prices in oil and other commodities could hamper America's economic recovery, but said he did not anticipate a big rise in inflation.

Revised data showed that China held $1.16 trillion in American **Treasuries** at the end of 2010, around 30% more than had been thought. Japan was the second-largest foreign holder of American government debt, with $882 billion in Treasuries.

The Securities and Exchange Commission laid a civil charge of insider trading against **Rajat Gupta**, one of America's best- known management consultants. Among other things the SEC alleges that Mr Gupta tipped off Galleon, a hedge-fund management firm, about a $5 billion investment that Warren Buffett made in Goldman Sachs in 2008. Galleon is alleged to have reaped $18m as a result of various information it received from Mr Gupta. A former head of McKinsey, Mr Gupta advises the UN on management reform. See article

This time, it's business-related

America's Supreme Court ruled that companies do not have a right to **personal privacy**. AT&T had argued that releasing documents from an investigation into the fees it charges schools contravened its personal privacy, but the court found that "personal" means "precisely the opposite of business-related...personal expenses and business expenses, personal life and work life, personal opinion and a company's view".

A ruling by the European Court of Justice that **insurance companies** could no longer use sex as a factor in setting insurance rates was widely criticised. Female drivers may now have to pay more for their car insurance, despite being a lower risk behind the wheel. In Britain, men, who have a shorter life expectancy, will no longer be entitled to higher annuities than women. See article

Blackstone agreed to buy the 588 strip malls in America that are owned by Australia's **Centro Properties**. Centro bought the malls before the financial crisis. The acquisition, valued at $9.4 billion, is Blackstone's largest since 2007.

PPL, an energy company based in Pennsylvania, won a bid for the electricity networks in Britain that are owned by Germany's **E.ON**. Last year PPL bought two power companies in Kentucky from E.ON, which is selling assets to help pay off debt and expand in emerging markets. PPL's $6.4 billion offer for E.ON's British business beat a rival bid from Li Ka-shing, Hong Kong's richest man.

Rupert Murdoch's **News Corporation** announced that it would spin off the news operations of **British Sky Broadcasting**, paving the way for its full acquisition of the satellite broadcaster (it already owns 39%). The takeover is controversial; News Corp is Britain's biggest newspaper publisher. Under its proposal News Corp will take a 39% stake in a publicly listed Sky News, finance it for ten years and guarantee its editorial independence. See article

Tweet mystery

It emerged that a fund run by JPMorgan Chase is seeking a minority stake in privately held **Twitter**, valuing the microblogging website at around $4.5 billion.

There was a political row in Bangladesh when the central bank moved to have **Muhammad Yunus** dismissed as managing director of Grameen, a pioneering bank in microfinance lending to the poor, ostensibly because at 70 he is above the mandatory retirement age. Mr Yunus, a Nobel prize-winner, has strained relations with the Bangladeshi prime minister. See article

Out of fashion

John Galliano was sacked as Christian Dior's lead designer for professional misconduct. This came after a video surfaced of Mr Galliano apparently making anti-Semitic remarks to customers in a Paris restaurant and declaring "I love Hitler". Mr Galliano was admitted to the French Legion of Honour in 2009.

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Oil and the economy

The 2011 oil shock

More of a threat to the world economy than investors seem to think

THE price of oil has had an unnerving ability to blow up the world economy, and the Middle East has often provided the spark. The Arab oil embargo of 1973, the Iranian revolution in 1978-79 and Saddam Hussein's invasion of Kuwait in 1990 are all painful reminders of how the region's combustible mix of geopolitics and geology can wreak havoc. With protests cascading across Arabia, is the world in for another oil shock?

There are good reasons to worry. The Middle East and north Africa produce more than one-third of the world's oil. Libya's turmoil shows that a revolution can quickly disrupt oil supply. Even while Muammar Qaddafi hangs on with delusional determination and Western countries debate whether to enforce a no-fly zone (see article), Libya's oil output has halved, as foreign workers flee and the country fragments. The spread of unrest across the region threatens wider disruption.

The markets' reaction has been surprisingly modest. The price of Brent crude jumped 15% as Libya's violence flared up, reaching $120 a barrel on February 24th. But the promise of more production from Saudi Arabia pushed the price down again. It was $116 on March 2nd-20% higher than the beginning of the year, but well below the peaks of 2008. Most economists are sanguine: global growth might slow by a few tenths of a percentage point, they reckon, but not enough to jeopardise the rich world's recovery.

That glosses over two big risks. First, a serious supply disruption, or even the fear of it, could send the oil price soaring (see article). Second, dearer oil could fuel inflation-and that might prompt a monetary clampdown that throttles the recovery. A lot will depend on the skill of central bankers.

Of stocks, Saudis and stability

So far, the shocks to supply have been tiny. Libya's turmoil has reduced global oil output by a mere 1%. In 1973 the figure was around 7.5%. Today's oil market also has plenty of buffers. Governments have stockpiles, which they didn't in 1973. Commercial oil stocks are more ample than they were when prices peaked in 2008. Saudi Arabia, the central bank of the oil market, technically has enough spare capacity to replace Libya, Algeria and a clutch of other small producers. And the Saudis have made clear that they are willing to pump.

Yet more disruption cannot be ruled out. The oil industry is extremely complex: getting the right sort of oil to the right place at the right time is crucial. And then there is Saudi Arabia itself (see article). The kingdom has many of the characteristics that have fuelled unrest elsewhere, including an army of disillusioned youths. Despite spending $36 billion

so far buying off dissent, a repressive regime faces demands for reform. A whiff of instability would spread panic in the oil market.

Even without a disruption to supply, prices are under pressure from a second source: the gradual dwindling of spare capacity. With the world economy growing strongly, oil demand is far outpacing increases in readily available supply. So any jitters from the Middle East will accelerate and exaggerate a price rise that was already on the way.

What effect would that have? It is some comfort that the world economy is less vulnerable to damage from higher oil prices than it was in the 1970s. Global output is less oil-intensive. Inflation is lower and wages are much less likely to follow energy-induced price rises, so central banks need not respond as forcefully. But less vulnerable does not mean immune.

Dearer oil still implies a transfer from oil consumers to oil producers, and since the latter tend to save more it spells a drop in global demand. A rule of thumb is that a 10% increase in the price of oil will cut a quarter of a percentage point off global growth. With the world economy currently growing at 4.5%, that suggests the oil price would need to leap, probably above its 2008 peak of almost $150 a barrel, to fell the recovery. But even a smaller increase would sap growth and raise inflation.

Shocked into action

In the United States the Federal Reserve will face a relatively easy choice. America's economy is needlessly vulnerable, thanks to its addiction to oil (and light taxation of it). Yet inflation is extremely low and the economy has plenty of slack. This gives its central bank the latitude to ignore a sudden jump in the oil price. In Europe, where fuel is taxed more heavily, the immediate effect of dearer oil is smaller. But Europe's central bankers are already more worried about rising prices: hence the fear that they could take pre-emptive action too far, and push Europe's still-fragile economies back into recession.

By contrast, the biggest risk in the emerging world is inaction. Dearer oil will stoke inflation, especially through higher food prices-and food still accounts for a large part of people's spending in countries like China, Brazil and India. True, central banks have been raising interest rates, but they have tended to be tardy. Monetary conditions are still too loose, and inflation expectations have risen.

Unfortunately, too many governments in emerging markets have tried to quell inflation and reduce popular anger by subsidising the prices of both food and fuel. Not only does this dull consumers' sensitivity to rising prices, it could be expensive for the governments concerned. It will stretch India's optimistic new budget (see article). But the biggest danger lies in the Middle East itself, where subsidies of food and fuel are omnipresent and where politicians are increasing them to quell unrest. Fuel importers, such as Egypt, face a vicious, bankrupting, spiral of higher oil prices and ever bigger subsidies. The answer is to ditch such subsidies and aim help at the poorest, but no Arab ruler is likely to propose such reforms right now.

At its worst, the danger is circular, with dearer oil and political uncertainty feeding each other. Even if that is avoided, the short-term prospects for the world economy are shakier than many realise. But there could be a silver lining: the rest of the world could at long last deal with its vulnerability to oil and the Middle East. The to-do list is well-known, from investing in the infrastructure for electric vehicles to pricing carbon. The 1970s oil shocks transformed the world economy. Perhaps a 2011 oil shock will do the same-at less cost.

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The Libyan conundrum

Don't let him linger

Should the Arabs and the West do anything to remove Muammar Qaddafi?

IF FOR nothing else, the dictators of Tunisia and Egypt must be thanked for bowing out rather than steeping themselves in blood. No such hurriedly happy outcome is promised in Libya, where Muammar Qaddafi seems bent on fighting back (see article). Even in defeat he may, like Samson, be ready to pull down the pillars of his rickety regime on his hapless people. If the death toll suddenly rises into the thousands, can the rest of the world stand idly by?

Surely not. But dislodging Libya's tyrant is proving hard. Rightly unnerved by the spectre of Iraq and Afghanistan, Western leaders will not wish to leap militarily into yet another fray (see Lexington). All the same, in case blood begins to flow much faster, Western leaders, in co-operation with existing and emerging Arab ones, should immediately begin planning how to establish a no-fly-zone over the country.

Doing nothing could make matters worse

It is vital for the lengthy and difficult reconstruction of Libya that Libyans themselves depose Colonel Qaddafi. The idea of putting Western soldiers' boots on Libya's sandy soil is thus still out of the question. But a no-fly zone could save thousands of Libyan lives, just as an earlier one saved Kurds in Iraq. Even then, it is fraught with technical difficulties, it cannot fully protect the Libyan rebels against Colonel Qaddafi's machinegunners and it is liable to "mission creep" (see article).

That makes it still more important for international involvement to have the backing of the Arab and Muslim world, especially the section of it that stands for progress and justice. This test is less clear-cut than it might be. The 22-member Arab League is in mealy-mouthed disarray; its secretary-general, Amr Moussa, is himself bidding to become Egypt's next president. The autocrats of the Gulf, especially in Saudi Arabia, are looking askance at the democratic upheavals all around them. Moreover, the Libyan situation is so fluid that no one knows which leader or what coalition of political forces may come to the fore or win legitimacy in the global arena. Among Libya's opposition, most people, though by no means all, seem ready to accept Western help.

As in all such mind-bending crises, it is best that the UN Security Council validates whatever course is pursued by the world's beefiest governments, still inevitably led by the West, which, in turn means the United States, backed by Britain and France, its hardiest allies with a modicum of military muscle. The Americans are fearful of becoming embroiled in yet another distant venture. Among the Europeans, only Britain and Italy seem readier for a more robust involvement (see Charlemagne). China and Russia, though they voted for UN sanctions on Colonel Qaddafi in the Security Council, presently balk at a no-fly zone, let alone armed intervention by troops. Turkey, a key member of NATO in Mediterranean or Middle Eastern affairs, is so far dead against, too. So, for the time being, it seems, are the majority of Arab governments.

But if the Libyan regime starts killing people in their thousands-and especially if it uses helicopter gunships or aircraft-diplomatic reluctance should melt away. Too often the world has dithered open-mouthed as evil men have slaughtered Darfuris or Rwandans with impunity. Outsiders, led by the UN, must help Libya's emerging transitional councils with humanitarian aid. The UN Security Council may yet have to be persuaded to restore peace by invoking the ample power of Chapter VII. And if that proves unattainable, the widest possible coalition of the willing, ideally including Libya's Arab neighbours, must protect Libyan civilians by arming the opposition and defending them from aerial attack.

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Emerging-market giants

Tata sauce

A new kind of global company is on the rise: diversified multinationals from emerging markets

OVER the past decade the world's corporate pecking order has been disturbed by the arrival of a new breed of plucky multinationals from the emerging world. These companies have not only taken on Western incumbents, snapped up Western companies and launched exciting new products. They have challenged some of the West's most cherished notions of how companies ought to organise themselves.

Many emerging-market multinationals are focused companies that are admired in the West: the likes of India's Infosys Technologies (for IT services), Brazil's Embraer (aircraft) and South Africa's MTN (mobile phones). But others are highly diversified. In some ways these groups look like throwbacks to old-fashioned Western conglomerates such as ITT. But in other ways they are *sui generis*: much more diversified and readier to blur the line between public and private.

The most remarkable of these is India's Tata group, active in everything from cars to chemicals and from hotels to steel; Tata is so big that several of its companies are important multinationals in their own right (see article). But others are also global forces: they include Alfa from Mexico, Koc Holding from Turkey and the Votorantim Group of Brazil. And dozens more are trying to break free of their national moorings. Tarun Khanna, of the Harvard Business School, calculates that such organisations are the most common business form in emerging markets. In India about a third of companies belong to wider entities. In Hong Kong 15 families control more than two-thirds of the stockmarket.

There are plenty of reasons to doubt the durability of these business groups. Many of them have thrived because they have close relations with their national governments. They are far too susceptible to scandal (witness the current furore in India over the sale of mobile-phone licences to favoured groups). Others are incapable of managing their diverse portfolios. Western stockmarkets habitually apply a discount to conglomerates' shares.

Yet there is more to these groups than cronyism. A growing number of them are proving that they can compete in global markets as well as in sometimes rigged local ones. The Boston Consulting Group lists the rise of diversified global conglomerates as one of five trends that will shape the future of business. Mr Khanna reckons firms that belong to India's business groups frequently outperform free-standing companies.

Such groups developed partly to deal with the problems of operating in places where governments are frequently incompetent and markets are hopelessly underdeveloped. Western management gurus love to advise companies to stick to their knitting. But in emerging markets your knitting may be your ability to stitch your way around underdeveloped markets rather than just your ability to manufacture a particular product. The key to Tata's success arguably lies in its ability to recruit talented local staff (against stiff Western competition) and to assure quality across a wide range of products.

The business groups are nimble decision-takers and have proved strikingly successful at seizing opportunities in other emerging markets. Koc's food-retailing business, Migros, has expanded throughout the Balkans and the former Soviet Union. Carlos Slim has extended his telecoms empire across Latin America. Tata also suggests that there may be yet

another advantage in diversification: the ability to develop skills across a wide range of businesses. Not only are various Tata companies trying to produce "frugal" products such as the Nano, an ultra-cheap car. They are pooling their resources: Tata Consultancy Services, Tata Chemicals and Titan Industries co-operated to produce the world's cheapest water purifier.

Masters and pupils

In the long run most of these emerging conglomerates are likely to follow the same path as Western companies: focusing on their core activities and buying ever more services from the market. But Western companies also need to recognise that-for the time being at least-these diversified giants have plenty to offer. Western firms may need to form joint ventures with "old-fashioned" conglomerates in order to win entry to fast-growing emerging markets. They may even find that they have to embrace diversification as they try to compete in these markets. The best emerging-market companies have learned a great deal from the West in recent years. It is time for Western multinationals to return the compliment.

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The Republicans in search of a nominee

A rival for the president

Bring forth a pragmatic Republican: he (or she) might win

CAN Barack Obama be beaten in next year's presidential election? That is the question that a squadron of nervous Republicans are asking themselves as they weigh up whether or not to jump into the fray, an undertaking that will cost them hundreds of millions of dollars and prove intrusive, exhausting and quite possibly humiliating. So far only two obscurities have declared themselves, a pizza mogul and a gay-rights activist. But the field is about to start filling out (see article).

In 2007 the race was already in full swing by now. The slow start, many reckon, is attributable to a severe case of cold feet. Incumbent presidents, on the whole, win re-election. The only three to be turfed out since the second world war have been the hapless Jimmy Carter; and Gerald Ford and George Bush senior, who were both running for re-election at the end of, respectively, two and three terms of Republican rule. Mr Obama's approval ratings, at around 48%, are respectable, and the economy is clearly recovering, though still fitfully (see article). He has a huge war chest and the slickest electoral machine that America has ever seen. He will, certainly, be hard to beat.

But not impossible. Consider that Mr Obama, who ran a pretty good campaign in 2008, beat John McCain, who didn't, by 192 electoral-college votes, a big number but not a landslide. The challenger needs therefore to switch states "worth" 97 votes to his (or her) column-a total that falls to 91 once you take into account the census which has helped the Republicans. Next, look at the 81 votes in five big swing states which plumped for Mr Obama in 2008: Ohio, Florida, Virginia, Indiana and Wisconsin. In all these places his appeal, especially to white working-class voters, has collapsed as the downturn has worn on and the implications of his expensive health-care bill have sunk in; the Republicans did well in them in the mid-terms. And some other states look promising: North Carolina, Colorado, Nevada and Minnesota. Above all, things can change, especially in a weak economy. The Republican starting position is considerably better than Bill Clinton's in March 1991 (when the older Bush's post-Iraq approval rating was 85%).

Let the elephants stampede

But the Republicans still have to find the right candidate. What would he or she look like? The next election could be dominated by some foreign event, but that is hard to plan for, and usually domestic policy is more important. Mr Obama's weaknesses are his perceived affection for big government, his lack of empathy with wealth-creators, his remoteness from the common man and the sense that he has never been a chief executive: witness the former senator's willingness to hand over the tough decisions about health care and the deficit to Congress. In 2008 Americans chose a charismatic leftish senator who spellbound them with his rhetoric; in 2012, with reform of their government a priority, they might choose a conservative pragmatist who has met a payroll.

The Republicans' first problem is Sarah Palin. She has a strong base in the "tea party", but she terrifies independents. Fortunately, the party is starting to understand this: at a recent conservative conference in Washington, DC, she picked up just 3% in a straw poll. But once you look beyond her, there is a reasonably impressive slate of moderates, headed by a clutch of governors who (unlike Mr Obama) have grappled successfully with budget issues: Mitt Romney, formerly of Massachusetts; Mitch Daniels, of Indiana; Jon Huntsman, formerly of Utah; Hayley Barbour of Mississippi; Tim Pawlenty, formerly of Minnesota; and Chris Christie of New Jersey.

At the moment none of them stands out. Mr Romney is the best-known-though he is hampered by his famously flexible convictions and his Mormonism (see article). Mr Christie, who is turning around a Democratic state by taking on Mr Obama's friends in the public-sector unions, says he is not running; others, including Mr Daniels, are hesitating. That is sad for their party, and also for America. A pragmatic alternative to Mr Obama would drag the president to the centre. And it would also leave independents who backed Mr Obama last time, like this newspaper, with an interesting choice.

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The cycle of immigration

Second life

From Brick Lane to Brixton to Bradford: the problems and promise of the trickiest generation

BRADFORD, 2001: Asian youths rioted, as they (and white youths) did in several deprived towns across northern England during a long, hot summer of unrest. Brixton, 1981: enraged young black men and others took to the streets, as they did in other British cities that year. Less famously, a little over a hundred years ago there was a brawl in Brick Lane, in east London, when Jewish anarchists riled the devout by eating ham sandwiches at the gates of a synagogue.

These distant events had very different contexts-including, in Bradford, the provocations of white extremists and, in Brixton, deep resentment of policing methods. Poverty was a common feature, but they share another: each involved angry second-generation immigrants. The members of this amphibious generation, which often straddles two worlds and cultures, are frequently troubled and sometimes troublesome, in Britain and elsewhere. When it extends to violence or cross-fertilises with radical ideologies, second-generation angst is a serious problem. But it can be ameliorated-and it has an upside.

The disorder in Bradford a decade ago was blamed by some on multiculturalism, a concept that, among its detractors, has come to connote tolerating or even encouraging separateness (see article). The segregation of Britain's Bangladeshi and Pakistani communities is indeed concerning, as is that of Germany's Turks and France's north Africans. Although comparisons between different groups and countries are shaky, the United States, with its immigrant folklore and self-improvement ethos, seems to manage integration better than Europe does. Across the sunbelt, Latinos can keep close ties with their countries of origin even more easily than many British minorities, yet their identities and loyalties seem relatively unconflicted. The same goes for most Arab-Americans-though American blacks are highly segregated by anyone's standards.

Yet blaming the disorder of 2001 on segregation alone is too simplistic. After all, some older members of Britain's Asian community complained that their second (and third) generations had picked up bad habits, such as public unruliness, from the locals. Similarly, a British sociologist writing about Jewish immigrants in 1900 admitted that anglicisation was hardly "a process of unalloyed improvement". Second-generation Jews, he wrote, "are apt to pick up the fashionable vices of their adopted country. If swearing, betting and a passion for the turf are to be taken as the hallmarks of our nationality, the young English Jew... must be allowed to be British to the core."

And the assertiveness of the second generation is not always a bad thing. It stems, in part, from a valid and valuable feeling: that second-generation immigrants are entitled to all the rights and opportunities of other citizens (though in Germany, whose Turkish immigrants have historically not been afforded equal rights, the situation is more complex). The first generation, by contrast, is typically more willing to live with slights and marginalisation, viewing them as part of the sacrifice of migration, and sometimes harbouring a hope of returning one day to its original motherland. Tricky intergenerational rifts sometimes result-as is the case with some British Muslims and was once the case with Britain's Jews-with the second generation regarding the first as cowed and meek.

The next second

The job of policy is to direct that legitimate feeling of entitlement towards civic engagement and away from radicalism. In Britain segregation is hard to tackle directly, since it often involves housing choices in which the government has no role. Policing has become more enlightened since the flare-up in Brixton in 1981. A bigger problem is jobs: although better-

educated than their parents, many second-generationers do less well than similarly educated white Britons. The country's anti-discrimination law is robust, but prejudices and inhibitions, as well as a broader social immobility, persist. Racially based quotas are not the answer-just look at America-but efforts targeted at the poor of all sorts can help,

The basic cause for optimism is that after the second generation come subsequent ones, who tend to do better and be less segregated. Black people in Britain, while still disadvantaged on some measures, are better integrated than at the time of the Brixton riots. The Jews are retrospectively regarded as model newcomers. But second-generation anger can cause serious trouble while it lasts; in any case, since migration to the rich world has not abated, there will be second generations of one sort or another for the foreseeable future. Best to try a little harder to make them feel less like second-best.

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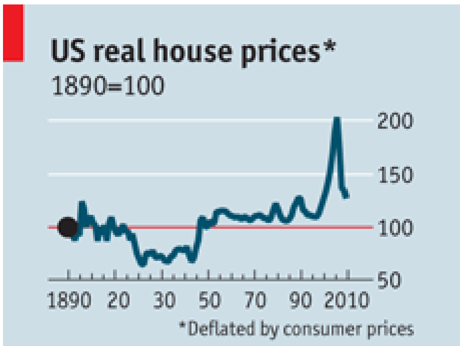
The perils of property

Home truths

Financial crises and property busts go together. The link can be weakened



PROPERTY'S grip on people is unrelenting. After the worst housing crash in memory, almost two-thirds of Americans still think that property is a safe investment. In Britain ministers hold summits to work out how to get first-time buyers into a market where prices are falling. In China anxious buyers queue to snaffle yet-to-be-built apartments. The world of commercial property is saner, but not by much. A bounceback in office values in London has prompted fears of a new bubble. Cranes dot the Chinese skyline, where more than 40% of the skyscrapers to be built over the next six years will be sited.

Property is more than just a place to live and work. For many people, it is the biggest financial bet they will ever make. That bet has been disastrous for plenty of homeowners. Over a quarter of mortgage-holders in America owe more on their loans than their homes are worth. House prices there have fallen back to 2003 levels and are still declining-by 2.4% year-on-year in December. A huge pipeline of foreclosed homes is still on its way to market: distressed transactions account for 66% of sales in California. Prices will probably fall again this year, sapping confidence and preventing people from moving to find work. Programmes to modify mortgage payments have been disappointing: for some underwater borrowers it may make more sense for the state to help reduce the principal.

At least prices in America are back to their long-run average compared with rents (see article). For those with cash, homes are more affordable than they have been for years. In many parts of Europe, prices still have a long way to fall to revert to that sort of value and there is lots of downward pressure. Oversupply weighs on the market in places like Spain, where a construction boom turned to bust. Credit is constrained (a big worry for commercial property, too, given the amount of debt that needs to be refinanced). The threat of rising interest rates looms over the many borrowers with adjustable mortgages.

In emerging markets policymakers have a different problem: holding prices down. A property bubble, many reckon, is the biggest threat to China's economy. A succession of measures have been introduced to subdue speculative buying and force developers to increase the supply of homes. There are sound reasons for prices to rise in China, given income growth and huge pent-up demand for decent housing. But policymakers are having to fight to keep things under control.

The properties of property

The irony is that property's appeal is founded on its supposed solidity. It is no coincidence that the housing bubble started in the aftermath of the dotcom bust. Out went fantasy business plans; in came a real asset with a proven record. But as our special report argues, property has dangerous qualities.

Explore and compare global housing data with our

One is its size. American households have more of their wealth in real estate than any other asset; it is a similar story elsewhere. So when things go wrong, the consequences are more serious than if there is a slump in equities, say. Worse, property is a magnet for debt. Lenders have to set aside less capital for loans against property because of its security as collateral. Individuals have no other opportunity to take on so much leverage. As prices go up, a deadly feedback loop forms: rising collateral values enable banks to extend more credit, which means prices can be chased higher. Things can spiral very quickly: there was a doubling of mortgage debt in America between 2001 and 2007. It is leverage that explains why property busts have a habit of causing financial crises.

Property is also an inefficient asset class. It is lumpy: you can offload parts of your share portfolio, but you cannot sell off the kitchen. It is illiquid, which can strand people in their homes even if they are not in negative equity. And it is inefficiently priced, not least because as an asset class it is hard to short: you can't hedge your exposure.

The devil is in the debt tale

So governments should be neutral about home-ownership, whose benefits have been oversold. People will always want to buy houses: they do not need a shove from subsidies. In America plans to wind down Fannie Mae and Freddie Mac, which buy and guarantee mortgages on the government's account, are welcome. Tax deductions on mortgage interest should go. So should distorting exemptions on capital-gains taxes; it is better to cut the transaction taxes that make it expensive for people to move.

Politicians will be loth to cut the value of their electorate's biggest asset, however. Which is why lots of people are now looking to central banks to intervene when property booms get going. That already happens a lot in Asia; Western central banks are also moving in this direction. The Swedes last year imposed a maximum loan-to-value ratio of 85% on mortgages, for instance. Good. Standing idly by is not much of a policy. And central banks have tools at their disposal, including interest rates, that can dampen things down.

Regulators have failed to spot bubbles in the past, however. And booms can be hard to stop when they get going: just ask the Chinese authorities. Discretionary interventions should be on top of standing rules, not instead of them. There should be no room for the wildest mortgage products-those that do not seek verification of income, say. But the systemic issue is the amount of debt that borrowers take on. Property busts are at their most destructive when borrowers fall quickly into negative equity (one reason to worry less about China is the small amount of debt that homebuyers have). A cushion of equity-10-15% of the property's value, say-should be required of new borrowers as a matter of course.

This should be phased in gradually. Unlike getting rid of mortgage interest relief, which is relatively painless when interest rates are already low, a minimum equity provision would hurt the economic recovery (especially in America, where the government is guaranteeing loans with tiny down-payments). And there is also a risk of excluding creditworthy borrowers, particularly first-time buyers and the self-employed. But it cannot wait too long. Asking people to save up for longer is a reasonable price to pay for a safer system.

Index | Letters

On political risk, revolution, voting, central banks, food, Canada, Indonesia, Chevron, strip malls, Joyce Carol Oates, the moon, history

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Letters are welcome via e-mail to letters@economist.com

Political business

SIR - Schumpeter was right to draw attention to the lack of interest from company managers about political risk (February 12th). That criticism can be extended to business schools, which, with some exceptions, still teach strategic management with a blissful ignorance of the political context of modern commerce. Read through several leading strategy textbooks and you will look in vain for any serious discussion of the place of government in the strategy process.

The term "political risk" does not help. It reinforces the tendency among academics and managers to see government as an irritating and unwelcome interloper in the otherwise smooth running of the market. It is also the case that for many managers, mention the word "politics" and they think of "corruption".

Many collective problems, from trade to the environment to labour issues, could do with more input from companies. More than a decade ago David Baron, an academic, drew attention to the need for firms to integrate market and non-market, that is political, strategy. A greater integration of political science and management studies would be an important step to answering his call.

In a world where many of the largest corporations are state-owned or sponsored by activist governments, the scholarship in management strategy desperately needs to update its thinking about the political environment.

Sreve McGuire
Professor of management
Aberystwyth University
Aberystwyth, Ceredigion

Revolution and economics

SIR - Your leader on the changes sweeping through the Arab world focused on political factors, but largely ignored the more materialistic anxieties present in these countries ("The awakening", February 19th). History provides us with many examples of political turmoil caused by declining living standards. James Chowning Davies, a political scientist, has tried to find a common thread that explains revolutions and unrest. Looking at the French, Russian and Egyptian (1952) revolutions as well as the American civil war and urban black riots of the 1960s, his "J curve" theory indicates that all of those examples occurred when a period of improving economic and social conditions was followed by a short, sharp reversal in those conditions.

Before the current economic crisis Arab nations such as Tunisia experienced consistent growth. These countries had stubbornly high unemployment rates, but the rally in commodities prices that saw food prices soar over the past year proved to be the straw that broke the camel's back. The Arab awakening is no less an aversion to a drop in living standards in these countries than it is a reaction to decades of oppression and injustice.

Economic downturns have ironically proved to be a more effective factor in fighting totalitarian regimes than any single piece of American foreign policy.

Nezare Chafni
Dubai

Weighing an MP's vote

SIR - Bagehot wrote about the fight to keep the Isle of Wight intact as one constituency in the House of Commons, rather than split it because it has too many voters (February 19th). But there is a way to retain political districts with distinct identities, even if over the years they have ended up with too many or too few voters.

In these cases constituencies could keep their historical boundaries, but their MPs would get a weighted vote in Parliament. For example, an MP from a constituency with a baseline electorate of 60,000 would get to represent one vote in

Parliament, whereas an MP from a district with 45,000 people would equate to 0.75 of a vote and his colleague with 72,000 voters would weigh in with 1.2 votes, and so on.

A constituency's borders could be redrawn only when a seat becomes worth more than, say, 1.5 votes or less than 0.5 votes in Parliament. With computers, counting votes in Parliament would be no more complicated than it is under the current system.

Hans Weytjens
Grunwald, Germany

Central bankers

SIR - I was delighted to see that *The Economist* has changed position and now argues that "short-term rates are too blunt an instrument to deal with the many threats that a financial system may face", and that macroprudential (non-interest rate) tools are needed to deal with financial imbalances ("A more complicated game", February 19th).

Did you not previously notice that policies which lean against the wind were typically espoused by those who had no responsibility for monetary policy-bankers, academics, journalists and some international institutions-while central bankers, who understand the many practical difficulties with such policies, were unpersuaded?

Stefan Gerlach
Managing director
Institute for Monetary and Financial Stability
Frankfurt

* SIR - Your briefing provided a thoughtful analysis of the role of central banks in financial systems. But the accompanying image of a chess match features an illegal back-row pawn and improbable positions: uncastled kings, strangely placed knights and bishops, overly ambitious rooks and a curious shortage of pawns, all pointing to a dangerous game being played by amateurs who have set everything up all wrong. Was this a subtle dig at central bankers?

William van der Kamp
Saskatoon, Canada

Food quote

SIR - Your special report on feeding the world (February 26th) incorrectly quoted me as saying that "the biggest contributors to the World Food Programme...are all BRICs" and that "when secretive North Korea began to engage in talks over nuclear disarmament, the first countries it spoke to were big grain exporters".

In fact, BRICs are not the largest contributor to the WFP, but they have recently joined the list of the 40 biggest contributors. And North Korea reached out to build diplomatic relationships in general, not necessarily because of nuclear disarmament. Many of the countries that were included in its outreach were big grain exporters.

Catherine Bertini
Senior fellow
Chicago Council on Global Affairs
Chicago

A shrinking state

* SIR - The notion that Canada remains "proud of its welfare state", and is "a country that the Liberals can recognise perfectly well, with big government largely intact" might have been true at the start of the 1990s, but no longer ("The circumspect and circumscribed Conservative", February 12th). Over the past 20 years Canada has cast off its socialist stereotype.

The tide started to change in the early 1990s with a left-wing government in Saskatchewan, followed by Conservative governments in Alberta and Ontario and the federal Liberals (a centre-left party), as governments of all ideological stripes began reducing excessive spending.

Spending by all levels of Canadian government peaked at 53% of the country's GDP in the early 1990s, plunging to 40% in 2008. In the early 1990s, the size of Canada's government sector was equal to the euro-area average and 22% above the OECD average. Today, our government is now 14% smaller than the euro-area average, slightly smaller than the OECD average, and just about one percentage point bigger than the United States.

Historic reforms were enacted to the country's welfare programmes in the mid-1990s. By 2000, the number of welfare beneficiaries in Canada had declined by more than a million people, from 10.7% of the population to 6.8%.

At over 40% of GDP, Canada's government is still much too large and economically damaging. But Canadians are not "proud" of the current welfare state. Health care, the largest component of government spending, continues to be dominated by the state but a great majority of Canadians (80%) want major reforms. And nearly 50% tend to support market-oriented reforms.

Many countries could learn valuable lessons from Canada. Over the past 15 years Canada has moved towards smaller government and lower taxes. The move however wasn't sparked by an ideological battle between liberals and conservatives; it just made good old Canadian sense.

Niels Veldhuis
Vice-president, Research
Fraser Institute
Vancouver

Asia's power to respond

SIR - Indonesia's introduction of quotas on Australian beef ("A row over cows", February 19th) is further evidence of a growing confidence in Asia to impose smart retaliatory trade measures on goods from rich countries. In Australia the unions orchestrate trade cases against Indonesian imports, the big supermarkets refuse to stock Indonesian products and the media are downright derisive about the country. Perhaps Jakarta decided it could just live without Australian beef. China learns even more quickly. Governments in the rich world succumbing to protectionist pressures should reflect on the unintended consequences and collateral damage to their exporters and investments in these high-growth Asian markets. We will probably see a lot more beef to come.

John Russell
Managing director
North Head
Beijing

A battle in court

SIR - Your article regarding the recent fine imposed on Chevron by a court in Ecuador in a long-running environmental lawsuit seemed to suggest there is some doubt about which party is being mistreated ("Monster or victim?", February 19th). A quick review of the case shows that Chevron has been subjected to a flawed process that has been condemned by multiple courts. Consider the following: Texaco Petroleum Company (TexPet), which Chevron later bought, was a minority owner, holding 37.5% of the oil consortium being sued in the case; the largest shareholder was Petroecuador, Ecuador's state-run oil company.

In the 1990s the Ecuadorean government approved the environmental remediation actually performed by TexPet, and released TexPet from any further liability when it left the consortium after its contract expired. The State Department and the World Bank have raised serious concerns about the rule of law and corruption in the Ecuadorean government and judicial system. Federal judges in New York, North Carolina, New Mexico, New Jersey and California have found the evidence in this case to be rife with fabrications, fraud and misconduct.

Facts and the basic rule of law demonstrate that Chevron is the victim.

Linda Menghetti
Emergency Committee for American Trade
Frank Vargo
National Association of Manufacturers
Stephen Canner
United States Council for International Business
John Murphy
US Chamber of Commerce
Washington, DC

Shop 'n' pray

SIR - The future of strip malls in America may well lie in "boutique" cities ("Stripped", February 19th). But something else interesting is happening. Although they were once considered an unattractive option for strip-mall developers because of their once-a-week traffic, churches are now being courted for their reliable rent and consistent attendance. Empty cinemas and oversize bookstores are the perfect choice for smaller churches looking to establish their presence without having to pay out for stained glass and a vaulted ceiling.

Many traditional churches are opening branches in strip malls to attract a younger and newer audience. With music concerts, youth groups and other activities held on days other than a Sunday strip malls get more traffic. As churches in the United States splinter into smaller, more contemporary units, I can only help but think that there is now something to believe in-at a strip mall.

Stephanie Kemler
Superior, Colorado

The book of love

SIR - Having recently become a widower, I was intrigued by Joyce Carol Oates's supposed misery in her memoir, "A Widow's Story" ("Give warning to the world", February 12th). Sceptical of those who use three names, and also of many writers of fiction (adapting George Bernard Shaw: those who can, do, those who can't, write), I find it odd that Ms Oates's husband, whose 50 years of closeness she claims to be missing, "never read her fiction", even though he was a literary editor. It is like being sexually active but having a celibate marriage. No wonder she wed again so swiftly.

Cecil Sanderson
Cheltenham, Gloucestershire

Waxing and waning

SIR - This must be the millionth letter you have received about your caption that wrongly labelled a picture of a waning moon ("Waxing in Rio", February 19th). Here's how to tell the difference. Hold out your right arm and look at your index finger and thumb; that's a waxing moon. Hold out your left hand; that's a waning moon.

Richard Smith
Los Angeles

Past times

SIR - With due respect to the use of historical idioms by both Lexington and Mark Twain (Letters, February 26th), I prefer the following: Every time history repeats itself the price goes up.

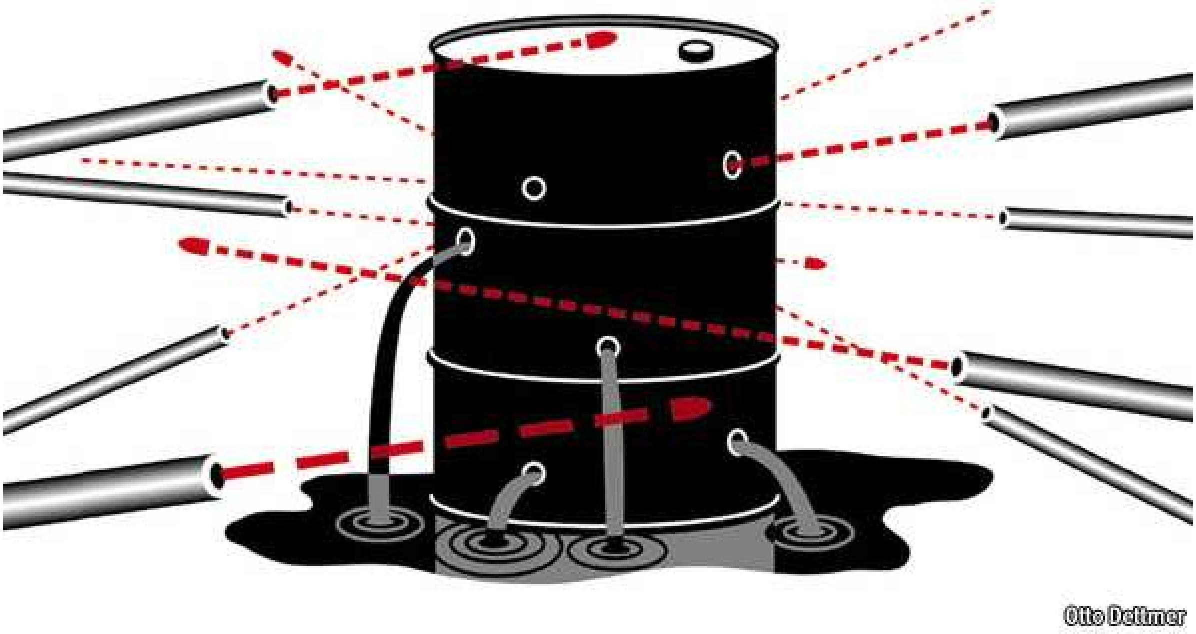
Jason Gart
Rockville, Maryland

* Letter appears online only

Oil markets and Arab unrest

The price of fear

A complex chain of cause and effect links the Arab world's turmoil to the health of the world economy



TWO factors determine the price of a barrel of oil: the fundamental laws of supply and demand, and naked fear. Both are being tested by the violence that is tearing through Libya, the world's 13th-largest oil exporter. The price of a barrel of Brent crude now hovers around $115. On February 24th, however, it rose to almost $120, as traders realised that they might have to do for a while without some or all of Libya's exports: some 1.4m barrels a day (b/d), or about 2% of the world's needs.

The situation in Libya is grim, as the rebels and the forces of Muammar Qaddafi battle for control of the country's only resource. Brega, the seat of the Sirte Oil Company in the east of the country, has changed hands three times in recent days. Most of the oil workers have fled, and production has fallen by two-thirds. The ports of As Sidra, Brega, Ras Lanuf, Tobruk and Zuetina, which together handle almost 80% of Libya's oil exports, were all seized by the rebels; two have now been retaken by Colonel Qaddafi's forces. The rebels remain in control of Africa's largest oilfield, Sarir, pumping some 400,000 barrels on a normal day. But for how long?

The history of oil is marked by Middle Eastern strife, supply shocks and global recession, with the Arab oil embargo in 1972, the Iranian revolution in 1978 and Saddam Hussein's invasion of Kuwait in 1990. To gauge the risks today you need to answer three questions. How vulnerable is the oil market to an interruption in supply? How sensitive is the world economy to oil-price spikes? And how well can policymakers cope with a shock if the worst happens? Take each in turn.

The troubles in Libya are only the most serious example of the impact of Arab unrest on global oil markets. Prices jumped as Egypt's citizens took to the streets to oust President Hosni Mubarak. Egypt is an oil importer, but acts as a vital conduit between the huge oilfields in the Persian Gulf and markets in Europe, via the Suez Canal and through the SUMED pipeline. Although it seemed unlikely that protesters would or could disrupt oil shipments, events in Cairo were enough to add more than $5 to a barrel.

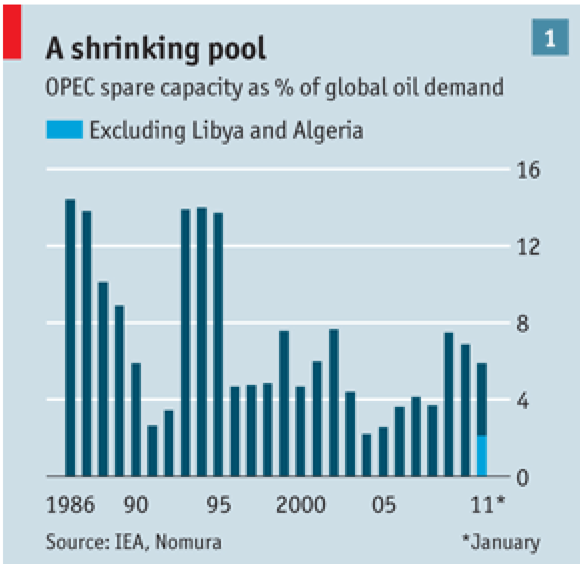
The spread of unrest to Bahrain, Oman and the Gulf has created a whole new dimension of anxiety. North Africa produces 5% of the world's oil, but the Middle East produces 30%. Moreover, Bahrain's problems are on Saudi Arabia's doorstep. These bear on the situation in the eastern Saudi provinces, from which a huge quantity of oil is pumped into global markets.

Saudi Arabia is therefore the traders' chief worry. But it is also, in oil terms, the world's chief hope. It is the only producer with significant spare capacity that could quickly be released if the oil price rose too high. Although OPEC, in which Saudi Arabia is the biggest force, exists to keep oil prices buoyant, it does not want to see them reach a point where the world economy is damaged and demand for oil falls. When prices spiked in 2008, the Saudis said they had capacity to spare. Terrified oil markets doubted its existence, and prices rose anyway, to reach $145. Yet the subsequent collapse in

the oil price in the second half of 2008 was only partly caused by the credit crisis and the rich-world recession that resulted. Saudi Arabia also pumped extra oil: nearly 2.5m b/d on top of the 8.5m it was already providing.

OPEC's spare capacity now is put at anything between 6m b/d (by OPEC) and 4m-5m b/d (by industry analysts); Saudi Arabia's share of that excess is perhaps 3m-3.5m b/d. The oil price has retreated from its peak in the past ten days largely because Saudi Arabia says it is pumping up to 600,000 b/d to replace the shortfall in Libyan exports. It has invested heavily in expanding capacity, with plans to spend perhaps $100 billion on wells and infrastructure by 2015. It has also been far more open about letting the world see what it has done. OPEC's stated aim of stabilising oil prices relies on traders believing that the Saudis really do have the capacity to pump more when prices rise.

Why, then, are traders still so nervous? The answer is that the long-term trends of supply and demand were already unfavourable when the Arab shoe-throwers intervened. Before the uprisings, a barrel of Brent crude was commanding close to $100 a barrel. World demand grew by an extraordinary 2.7m b/d in 2010, according to the International Energy Agency. It will probably keep growing by another 1.5m b/d this year and the same again next, as the rich world recovers and demand surges in China and the rest of Asia. Net expansion of non-OPEC supplies is likely to be negligible in the coming years. Though the rich world's inventories are high, with cover of around 50 days, it is not clear that Saudi Arabia can pump much more than it did in 2008; and the speed of oil released from government reserves, such as America's Strategic Petroleum Reserve, also has upper limits.



If disturbances hit Algeria and threaten its oil industry too, the buffer of spare capacity would fall below where it stood in 2008. But demand now is much higher, so spare capacity as a proportion of that demand is much lower (see chart 1).

When oil markets tighten, another set of problems emerges. Saudi oil is generally more dense and sulphurous than the Libyan crude it will replace. Europe's creaky old refineries will not be able to process the heavier Saudi crude, and fuel regulations there are less tolerant of sulphur content than elsewhere in the world. So the Gulf oil will have to be shipped to Asia's newer refineries, which are designed to deal with a wide variety of grades of oil. West African oil, a close substitute for Libya's output which usually goes to Asia, will be sent to Europe instead.

If the supply situation worsens, opportunities for this type of substitution will be fewer, creating supply bottlenecks, shortages of petrol and spikes within price spikes for different crudes and products, even when spare capacity remains. The price differential of about $15 a barrel that has built up between Brent crude, which more closely reflects global trade, and West Texas Intermediate, the benchmark for oil prices in America, is a good example of how oil markets can become distorted by local patterns of supply and demand. If supply gets even more stretched, oil could fetch a far higher price in some parts of the world than others. If supply problems become really grave, oil companies may even declare *force majeure*, raising the prospect that, as in 1978, oil markets fail altogether.

That is still a remote prospect, and the upward march of the oil price seems to have paused for now. The crucial question is how much oil will be lost, and for how long. When oil markets operate at the limits of supply, even the smallest extra disruption has a disproportionate effect. On February 26th, for example, Iraq's biggest refinery shut down after a terrorist attack. This and other assaults could knock out another 500,000 b/d from the world's fuel supplies. And if the raids on oil installations in previous elections in Nigeria are anything to go by, the next one, in April, may threaten another 1m b/d of supplies from west Africa. Meanwhile, Saudi Arabia remains far from secure (see article). On March 1st the country's stockmarket, jittery about the neighbours, plunged by 7%, a worrying sign that confidence is fading.

Hobbling the world

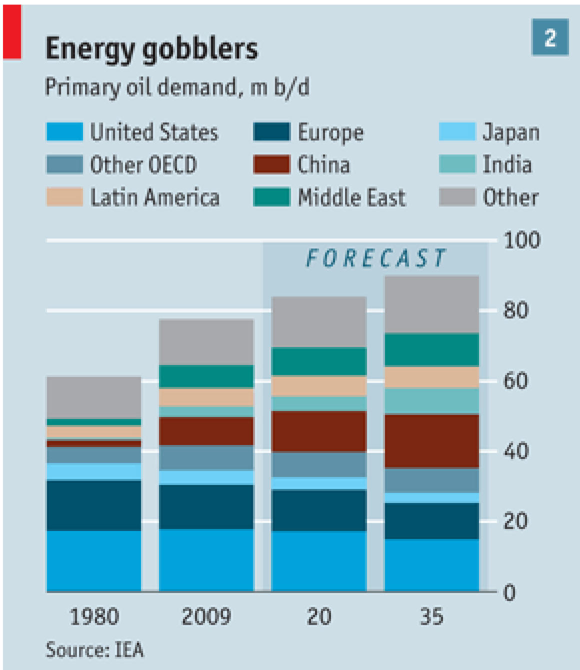
All this is a dark cloud on an otherwise bright horizon for the global economy. Few things can short-circuit growth like an oil shock, both because of the fuel's ubiquity and because of the relative insensitivity of demand. When the oil price jumps, consumers have little choice but to accept it, spending less on something else.

So how sensitive is the world economy to oil prices? Thus far the rise, and the likely damage, both look modest, in part because many forecasters had expected an increase this year anyway. Since the end of last year the price of Brent has risen by $23 a barrel, or about 25%, and West Texas Intermediate by $10, or 10%. The IMF reckons that a 10% increase in the price of crude shaves 0.2%-0.3% off global GDP in one year. As it happens, crude oil (using a blend of several grades), is now about 10% more costly than the IMF assumed in late January, when it projected global growth of 4.4% this year. That implies that the Fund would now foresee growth of about 4.2%.

Economists do not expect a repeat of the 1970s, when oil-price rises led to "stagflation" in the rich world. Olivier Blanchard, chief economist of the IMF, and Jordi Gali, of the Centre de Recerca en Economia Internacional in Barcelona, point out that two recent oil-price rises-one beginning in 1999 and another in 2002-were of the same order of magnitude as during those turbulent years. But the effect on both inflation and unemployment in the rich world was much smaller: in America, for example, a rise in inflation of only 0.7 percentage points on average, whereas the 1970s shocks had caused a rise of 4.5 points in the two years after the shocks.

The rich world is less vulnerable now because it has substantially reduced the amount of oil used per unit of output. America's economy in 2009 was more than twice as large in real terms as in 1980. Yet over that period America's oil consumption rose only slightly, from 17.4m b/d to 17.8m. Europe actually used less oil in 2009 than in 1980, even though its economy had grown.

Other factors may also have helped. Supply shocks generate larger increases in inflation and bigger falls in output when wages are rigid. So oil shocks have smaller effects today, because labour markets in rich countries have become considerably more flexible since the 1970s.



Emerging economies may be hit harder by a spike, since they use more oil per unit of output than rich countries do (see chart 2). America's economy, though about three times the size of China's, uses just over twice the amount of oil that China's does. But oil intensity in emerging countries has also been falling in recent years, as manufacturing has become more efficient and less energy-intensive service industries have increased their share of the economy. So even these countries are less vulnerable to an oil shock than they used to be.

Among rich economies America tends to suffer the biggest immediate impact, because its economy is relatively energy-intensive and because its low petrol taxes interpose only a small wedge between crude oil and petrol prices. Goldman Sachs estimates that a 10% price increase trims GDP by 0.2% after one year, and 0.4% after two.

In Europe the effect is muted by lower energy intensity and high levels of tax. Excise and value-added tax represents roughly 60% of petrol prices and 52% of diesel prices in the euro area, according to the European Central Bank (ECB).

Emerging Asia is more complicated. Although its economies are more oil-intensive, several also export oil, and many subsidise fuel, limiting the impact on consumers. Thailand has resolved to hold the price of diesel below 30 baht (about $1) a litre until April; without the subsidy, which was raised on February 24th, it would be 34 baht. Citigroup estimates that each $10 increase in the price of oil costs India's state-owned oil-marketing companies the equivalent of 0.5% of GDP, of which half is absorbed by the budget. An IMF staff study has estimated that emerging and developing countries subsidised fuel by about $250 billion in 2010.

Loosening, or tightening?

What can central banks do to protect the economy? Higher oil prices act as a tax on countries that import the stuff, which would normally call for easier monetary policy. But they also raise inflation, which calls for tightening. A one-off rise in prices would not produce a sustained increase in inflation, unless it boosts firms' and workers' expectations of future inflation, which can become self-fulfilling. The oil-price shocks of the 1970s rapidly found their way into broader inflation. Central banks had to clamp down drastically to suppress their inflationary effects.

In recent years, with inflation expectations more stable, central banks have responded more moderately to higher oil prices. But in July 2008 the ECB raised short-term interest rates because it feared that a rise in headline inflation would feed a wage-price spiral. In retrospect, that was a mistake. The global economy was already slowing, and over the next year both headline and core inflation (which excludes energy) fell sharply in the euro zone. Although America's Federal Reserve did not tighten, it hinted at the possibility, which prompted markets (wrongly) to anticipate a rate increase. These hawkish signals may have compounded the slide in economic activity already under way.

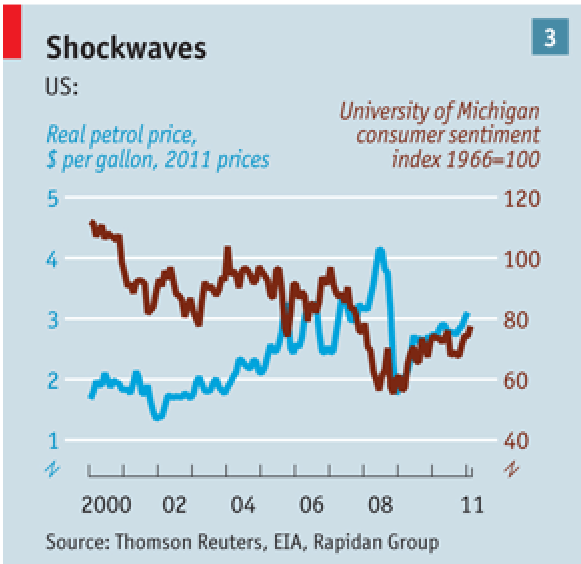
This year their response is likely to be more subdued. Unemployment is higher in America and Europe than in 2008, and underlying inflation, except in Britain, is lower. At a forum on February 25th at the University of Chicago, officials from both the European and American central banks signalled willingness to hold fire unless inflation expectations grow. On March 1st Ben Bernanke, chairman of the Federal Reserve, said the recent rise in commodity prices would probably "lead to, at most, a temporary and relatively modest increase" in inflation.

In many emerging markets the risks are greater. Those economies are already operating at capacity, and both overall inflation and core inflation have risen: China's January inflation rate was 4.9%, well above its official 4% target, and India's was more than 9%. An increase in the price of energy can cause a steeper jump in inflation in emerging markets, because in many it has a larger weighting in their consumers' baskets: 15.2% in Indonesia, 14.2% in India and 13.8% in Malaysia, compared with about 9% in America's. Moreover, energy is a large input in food production, which has an even bigger weight.

Monetary policy has also been relatively loose in these countries, with real short-term interest rates negative in many of them, including, by some measures, China. Johanna Chua of Citigroup reckons that monetary conditions, including both interest rates and the exchange rate and, in China's case, credit growth, have tightened already in Asia, but need to tighten further in both China and India.

The reason for a rise in the oil price is as important as how large it is. An increase forced by higher demand is less dangerous than one driven by constricted supply, because it is evidence of a healthy global economy. If rapid growth means that China and India are importing more oil, they are probably importing larger amounts of other things as well, lessening the pain for slower-growing consumers of oil.

Nonetheless, whether driven by demand or supply, a large enough spike in the price of oil can do great damage. Economists call such abrupt responses "non-linearities" and they suggest that when the price rises fast enough, consumers and businesses trim their spending and investment plans. This is often because prices are driven by other factors that hurt confidence, such as wide unrest in the Middle East. If another Arab government were toppled, pushing the oil price over $150, the economic impact would almost certainly be larger than the 0.5% to 1% of GDP that simple extrapolation suggests.



James Hamilton, of the University of California, San Diego, has identified numerous periods since the late 19th century in America when an abrupt rise in the price of oil or petrol coincided with recession. Many of these were caused not by an interrupted supply, but by demand growth colliding with unresponsive supply. That seems to explain the price spike above $140 in mid-2008. Although the financial crisis was the main cause of the recent recession, Mr Hamilton argues that oil explains why the economy had already begun contracting before the worst of the crisis hit that autumn. Robert McNally, of Rapidan Group, a consultancy, concurs, arguing that American consumer confidence fell sharply once petrol went past $3 a gallon (see chart 3). It is now at $3.38, after the biggest one-week increase since Hurricane Katrina in 2005.

Even if the unrest leaves supply unaffected, significantly higher prices may be only a matter of time. The same dynamic that drove the oil price skyward in 2008 is steadily reasserting itself. Supply is not growing substantially, and global demand, which regained its pre-recession peak last year, is expanding briskly again.

Given enough time, the rich countries should be able to adjust to higher prices. Jim Burkhard of IHS Cera, a consultancy, notes that OECD oil demand peaked in 2005 and has been slipping since in response to the upward march of prices. In America a shift in consumer purchases towards more fuel-efficient vehicles, ethanol mandates and higher fuel-economy standards have all capped growth in petrol demand. Meanwhile, the higher world price has unlocked new supply within the United States, and elsewhere, which was previously too expensive to exploit.

Yet it may take years for such trends to dent demand and boost supply by much; and the world may not have a lot of time. "Historians will look back on 2008 as the first time in modern memory that spare capacity ran out without a war in the Persian Gulf, and OPEC failed to cap prices," says Mr McNally. "Eventually we'll replay that scenario. If OPEC can't control the market any more, that means prices will have to swing much more."

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The Republicans

Who dares take him on?

Despite their victories at the mid-terms, the Republicans seem oddly slow to start choosing a presidential candidate

BY THE absurdly elongated standards of American politics, next year's presidential election is not that far away. It is less than a year until the first primaries and caucuses. By this time four years ago eight Republicans and ten Democrats had already thrown their hats in the ring; so far this year no serious candidate has done so, though Newt Gingrich, a former House speaker, has supposedly been on the point of declaring for some days. No presidential election, in fact, has got off to such a slow start since 1992-when, as now, there was an incumbent president and no obvious front-runner ready to take him on. There is no shortage of Republicans who consider themselves presidential timber, of course. But their slowness to register officially as candidates is an indication of the peculiar dynamics of the race.

The main thing holding Republicans back is doubt about whether Barack Obama is beatable. After their thumping success in the mid-terms, many of the party's leaders declared that they were well on their way to retaking the White House. But that is a daunting task: only three sitting presidents have lost re-election bids since the second world war. All three-Gerald Ford, Jimmy Carter and George Bush senior-faced determined primary opponents, whereas disgruntlement with Mr Obama on the left, though considerable, does not appear severe enough to spawn a vexing challenger. (Such fringe challengers tend to split their parties with unfortunate consequences.) Moreover, Messrs Ford and Bush were ousted only after the White House had been under the control of their party for eight and twelve years respectively. Mr Obama took office just two years ago, after eight years of Republican sway.

Mr Obama is also a stellar campaigner, with an unrivalled ability to attract volunteers and donations. He has been careful over the past two years to preserve the machine that got him elected last time, merely changing its name from Obama for America to Organising for America. The assumption is that he will mount as slick and well-funded a campaign in 2012 as he did in 2008. As Haley Barbour, governor of Mississippi and a potential Republican candidate himself, said recently, Mr Obama "is one of the greatest politicians in the history of the United States".

There are reasons to think Mr Obama is vulnerable, however. The economy, the most important factor in almost all elections, remains weak. Unemployment, at 9%, is higher now than it has been at any election in the past 60 years. High unemployment, of 7.5%, contributed to Mr Carter's defeat at the hands of Ronald Reagan in 1980. True, Mr Reagan then won re-election four years later despite a similarly grim rate, of 7.2%; the difference was that the economy was strengthening during Mr Reagan's re-election campaign, but had weakened during Mr Carter's. One reason Republican candidates may be procrastinating, pundits reason, is to wait and see whether Mr Obama's situation is more like Mr Reagan's or Mr Carter's.

A few mooted contenders have already ruled themselves out of the race. John Thune, a photogenic senator from South Dakota, announced in late February that he would not run. Mike Pence, a congressman from Indiana, seems to have settled on a tilt for the state's governorship instead. Chris Christie, the governor of New Jersey and an idol of deficit hawks, has repeatedly and vociferously denied having any presidential ambitions. So have Rick Perry, the long-serving governor of Texas, and Marco Rubio, a charismatic young senator from Florida who would be a big draw for the Hispanic vote,

which the Republicans have foolishly alienated by their opposition to immigration reform. Many of these are thought to be biding their time until 2016, when Mr Obama, if re-elected, would have to step down, leaving no incumbent candidate.

Republican runners and riders

In a (very rough) ranking of their chances

Candidate	Former/current job	Pros	Cons
Mitt Romney	Ex-governor/businessman	Rich, experienced	Wooden, Mormon, flip-flopper
Tim Pawlenty	Ex-governor	No baggage	No charisma
Mitch Daniels	Governor	Moderate, capable	Short, bookish, irks religious right
Sarah Palin	Ex-governor/VP candidate	Tea-party heroine	Scares everyone else
Mike Huckabee	Ex-governor	Evangelical hero	Evangelical
Newt Gingrich	Ex-speaker	Took on Bill Clinton	Lost
Jon Huntsman	Ex-governor/ambassador	Rich, good-looking	Works for Obama, Mormon
Michele Bachmann	Congressman	Palin-lite	Still fairly Palin-ish
Chris Christie	Governor	Electable	Says not in the race
Haley Barbour	Governor	Connected, capable	Jowly Southern lobbyist
Ron Paul	Congressman	Loyal following	Crank
Donald Trump	Showman	Rich, famous	Laughing stock
Rudy Giuliani	Ex-mayor	Inspirational on 9/11	Completely flopped in 2008
Herman Cain	Pizza mogul	In the race	Not electable
John Bolton	Ex-UN ambassador	Combative ideologue	Combative ideologue

Nonetheless, the Republican field remains wide (see table). In addition to Mr Gingrich, Mitt Romney, a former governor of Massachusetts and strong competitor for the nomination last time around, seems certain to run. So do Tim Pawlenty, a former governor of Minnesota, Jon Huntsman, a former governor of Utah and Rick Santorum, a former senator from Pennsylvania.

Others are running or toying with it not because they have any hope of winning the nomination, but in order to raise their profiles, bask in the media's gaze or champion pet causes. Into this category falls John Bolton, a former ambassador to the United Nations who is mulling a run, presumably in order to propagate his muscular approach to foreign policy. Ron Paul, a libertarian congressman from Texas who commands a small but devoted following for his unstinting hostility to the Federal Reserve and foreign entanglements, is also likely to enter the fray. Both look like strong contenders compared with Donald Trump, a self-promoting businessman and television star who says he is considering joining the race because no other candidate has even a fraction of his talent.

Then there is a contingent whose intentions are not yet clear. By far the most prominent and intriguing of these is Sarah Palin, the Republicans' vice-presidential nominee last time around. As a heroine of the tea-party movement, she would become an instant front-runner if she entered the race. But many suspect that she is stoking the endless speculation about her intentions simply to advance her lucrative latest career as an author, public speaker and television commentator. At any rate, she has not yet put in place even the rudiments of a campaign team, having only just hired a chief of staff to co-ordinate her political activities.

Mike Huckabee, a former governor of Arkansas and the runner-up in the primaries of 2008, is also coy about his plans. He, too, is enjoying a new incarnation as an author and pundit, and has agonised publicly about whether or not to run. Rudy Giuliani, a less successful candidate from 2008, is another hemmer and hawer. Mr Barbour and Mitch Daniels, the governor of Indiana, say they will not make up their minds until April, when the current legislative sessions in their states end.

These and other waverers will decide in part based on who else is running. If Mrs Palin jumps in, other tea-party favourites such as Michele Bachmann, a congresswoman from Minnesota, and Jim DeMint, a senator from South Carolina, are much less likely to follow suit. By the same token, Messrs Barbour, Daniels, Giuliani, Huntsman, Pawlenty and Romney would all be competing for more or less the same constituency, as tested, pragmatic, business-friendly centrists with conservative veneers of varying thickness. There is less competition for the attention of the party's Christian wing, with Mr Huckabee and Mr Santorum the only natural fits. That is no accident: the Republicans tend not to nominate their most socially conservative candidates, despite their supposed resonance with the party base.

Those on the fence have several incentives to stay there for some time yet. Most have set up "political action committees"-pressure groups that can raise big donations from businesses and individuals to fund speaking tours and the like. Many potential candidates also have sidelines as authors that take them, conveniently enough, to book signings in states with early primaries. No fewer than five potential candidates-Mrs Palin and Messrs Bolton, Gingrich, Huckabee and Santorum-have contracts as talking heads with Fox News, which bring them straight into the living rooms of likely primary voters. Once they officially declare themselves as candidates, however, election laws heavily regulate fund-raising for, and spending on, anything that could be construed as campaigning, not to mention access to the airwaves. Fox this week suspended Mr Gingrich and Mr Santorum, pending clarification of their plans.

Yet candidates cannot afford to dither indefinitely. They need to start raising money, hiring staff and setting up offices in the early-primary states. Those without household names will want to begin raising their profiles. Even the better known candidates will remember the example of Fred Thompson, an actor-turned-politician who waited to enter the last presidential race until September 2007, only to fall completely flat.

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Mormons in politics

When the saints come marching in

Can a Mormon get to the White House?

THE Church of Jesus Christ of Latter-day Saints, also known as the Mormon church, is in a tizzy now that not one but two of its members, or "saints", seem about to vie for the Republican nomination for president of the United States. Mitt Romney and Jon Huntsman (see article) both seem determined to try to test the limits of discrimination.

For most of the 181 years since Joseph Smith published the Book of Mormon, such prominent Mormon candidacies for the highest office would have been unthinkable. Mainstream Protestants, and especially evangelicals, have traditionally considered Mormons a devious cult, not quite Christian and just plain wacky.

This distrust keeps peeking through. Mike Huckabee, a Southern Baptist and another Republican candidate, insinuated just before the Iowa caucus in January 2008 that Mormons believe that Jesus and Satan are brothers (Mr Huckabee promptly went on to defeat Mr Romney in that caucus). Last year, when an evangelical Republican in Nevada, Sharron Angle, challenged Harry Reid, a Mormon and a Democrat who is the majority leader of the Senate, her pastor called Mormonism "kooky" and alleged that "Harry Reid's allegiance is to Salt Lake City," that Mormons "do illegal things" and that "there's weirdness going on there".

Protestants once murmured similar things about the Catholic John Kennedy, with Rome taking the place of Salt Lake City, but have since got over their distrust of papistry. They seem to find Mormonism harder to accept. How plausible is it that a semi-literate man in upstate New York should find golden plates written in "reformed Egyptian" and translate them, while burying his face in his hat, to reveal the tale of a family who left Israel in 600BC and ended up in North America? Then again, to be fair, how plausible are the miracles and resurrection of Jesus?

Mormonism makes many other claims that seem ambitious in the modern world. In 1890 the church banned the polygamy for which it used to be notorious. But Mormons continue to believe, for example, in direct and ongoing divine revelation, which is why the church's president, currently Thomas Monson, is considered a prophet and his quorum of church leaders are deemed apostles.

Yet in practical matters Mormonism seems well adapted to the modern world, for Mormons are, by many measures, disproportionately successful. Harvard Business School, it is often said, is dominated by the "three Ms" (McKinsey, the military and Mormons). Wall Street and the Central Intelligence Agency love to hire Mormons. And Mormons now make up almost 3% of Congress, even though they are less than 2% of the population.

For this, Mormons may have their austere religious practice to thank. The church has no paid professional clergy, so all boys from an early age learn to become church leaders. Young men (and some women) also tend to go abroad as

missionaries, usually after rigorous study of a foreign language (Mr Romney learned French, Mr Huntsman Mandarin Chinese in Taiwan).

Many missionaries become paragons of self-discipline, with their trademark white shirts and ties and a teetotalling, non-smoking, caffeine-free and abstinent Mormon work ethic. That experience-and perhaps the need to cope with repeated ridicule-seems to make many Mormons not only cosmopolitan but also resilient. Many become good salesmen and communicators, or indeed politicians.

Through their faith, Mormons tend to inherit many quintessentially conservative values, above all an attachment to the family. Mormons believe that families remain linked together eternally after death, and that one can even include ancestors into this union by retroactively baptising the dead. This explains why the church maintains probably the world's most sophisticated genealogical database.

But other aspects of Mormonism have liberal, even socialist, elements. Joseph Smith had an egalitarian vision. The church demands, for example, that Mormons pay 10% of their income as a "tithe" to the church, although argument remains about whether this should be applied to income net of government taxes.

The mixture has created overwhelmingly conservative politics in heavily Mormon states such as Utah and Idaho, but with a pragmatic twist, says Kirk Jowers, a Mormon and the director of the Hinckley Institute of Politics at the University of Utah. It may not be a coincidence that Mr Romney in Massachusetts and Mr Huntsman in Utah made the two biggest state-level efforts to reform health care (Mr Romney's reform even resembling Barack Obama's to a striking degree).

The debate on immigration is another example. The author of a harsh state law against illegal immigrants in Arizona, passed last year, is a Mormon. But as Utah began debating its own version, with anti-immigrant rhetoric taking on racist tinges, the state's overwhelmingly Mormon policy elite formed a "Utah compact", an agreement to keep the debate civil and empathetic toward all. The church gave this compact a nod of approval, citing the sanctity of families, including those of illegal immigrants, who might be split up by deportations. It is also aware that more than half of Mormons are outside the United States, many in Latin America.

If both the more pious Mr Romney and the more secular Mr Huntsman, who have been personal rivals in the past, run in the primaries, their Mormonism will become an issue again. A few Mormons may even stoke it themselves. For instance, Glenn Beck, an excitable television host, likes to allude to something called The White Horse prophecy, according to which America's constitution, deemed to be divinely inspired, will one day "hang like a thread" until Mormon leaders rescue it.

But mainstream America may learn to get over its old and unpleasant distrust. The core of Mormon philosophy, says Michael Otterson, the church's spokesman, is "the idea of self-improvement". What, after all, could be more American? The church is now waging a large advertising campaign to show the diversity of Mormons in America. "We're not prepared to be defined by others" any longer, insists Mr Otterson.

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The budget

Continuing irresolution

A crisis averted, but only for two weeks

Mitch McConnell sees a glimmer of hope

THERE were predictions of brinkmanship, recrimination and, in all likelihood, a shutdown of much of the federal government. But in the end, ahead of schedule and with near unanimity, Congress agreed this week on a "continuing resolution", meaning a temporary measure to finance the government in lieu of a fully fledged budget. The day of reckoning, however, has only been postponed, and by a mere two weeks at that. By March 18th the Republican-controlled House of Representatives and the Democrat-controlled Senate must agree on another spending measure, or the non-essential bits of the government will have to shut up shop.

The Republicans want to see non-defence discretionary spending, meaning all but the expensive bits of the budget, trimmed by $61 billion, or about 10%. The Democrats say that is far too ruthless: in his budget for next year, Barack Obama proposed the much milder formula of a spending freeze. The two sides have bridged this gap for now by agreeing to cut $4 billion for starters. That suited the Republicans, in so far as the pace of the cutting is in keeping with the $61 billion target for the remainder of the year. But it was also fine with most Democrats, in that the axe fell only on programmes that the president had already suggested eliminating, or on "earmarks", pet projects of individual congressmen which both sides have pledged to forgo in future.

There is scope for a little more fat-trimming along these lines. There are still a few earmarks that could be rescinded. The Government Accountability Office, an official watchdog, produced a report this week identifying billions of dollars that could be saved by streamlining the federal bureaucracy. But it seems unlikely that the Republicans' full target can be met painlessly. Their proposal includes cuts to worthy and popular items such as college scholarships for the poor and nutrition schemes for babies.

Democrats have vowed to protect those sorts of things, and have instead proposed eliminating a tax break for oil companies. Mr Obama, for his part, has complained that living from fortnight to fortnight is no way to run a country. And another deadline is looming: the Treasury has warned that it may reach the ceiling Congress has imposed on government debt as early as April 15th. Mr Obama has now placed himself at the centre of negotiations, by instructing the vice-president, Joe Biden, as well as his budget director and chief of staff, to hammer out a compromise with the Republican and Democratic leaders of both House and Senate.

The Republicans are nonetheless crowing that they have finally managed to start a debate about the proper magnitude of cuts, rather than whether to cut at all. "It is at least the first time since I've been here that I can recall cutting anything of any consequence, and I hope that's the beginning of a trend," said Mitch McConnell, the leader of the Republicans in the Senate.

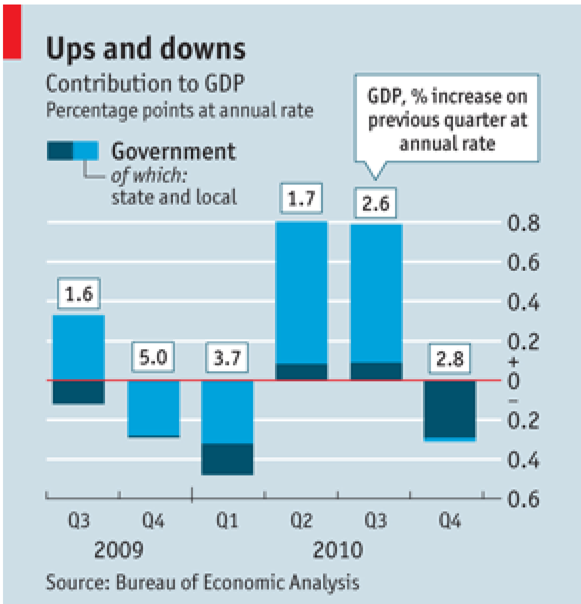
That is not quite the achievement that it sounds. The cuts so far have been the easy stuff; reaching agreement on anything else will be much harder. Meanwhile, the uproar surrounding the continuing resolutions has drowned out any discussion about the expensive bits of the federal budget that really do need cutting: government spending on health care, pensions and the armed forces.

The economy

Fits and starts

Batten down the hatches, it's going to be a stormy recovery

IF AMERICANS have learned anything from their recovery, it is that nothing can be taken for granted. Growth may deliver new jobs, or it may not. Recovery may be under way, but a crisis on the other side of the Atlantic could derail it. In the fourth quarter of last year America seemed at last to shake off the effects of the summer's European jitters. A first estimate put growth in the last three months of 2010 at a 3.2% annualised pace. The economic expansion appeared to be accelerating. Or maybe not. On February 25th the Bureau of Economic Analysis revised GDP growth down to just 2.8%, scarcely more than the 2.6% performance in the third quarter.



Several factors contributed to the revision. Imports grew more, and personal consumption less, than originally reported. But a larger than estimated drag from state and local government cuts played a significant role. Of the 0.4 percentage points trimmed from the GDP estimate, about half was attributable to local government austerity (see chart). And because high unemployment is lingering, these governments will have to deal with bigger budget gaps for longer than they expected. A projected $125 billion state budget gap in the 2012 fiscal year will come close to matching the $130 billion hole governments faced in fiscal 2011. Cuts to government programmes will add public employees to the ranks of the jobless, complicating the unemployment picture.

Unlike most states, the federal government is not obliged to balance its budget, and deficits have reached record levels recently. The rise in public debt complicates a long-run budget picture darkened by the shadow of a looming spike in entitlement spending. But there is no immediate crisis. Given the weakness of the recovery, adoption of a credible plan to address deficits over the next few years is the safest course of action. Republicans in the House of Representatives, not content to wait, have committed to chopping $61 billion from planned spending in the current fiscal year. Some say their impatience is risky. Mark Zandi, chief economist at Moody's Analytics, reckons that Republican cuts could lead to the loss of up to 700,000 jobs, while Goldman Sachs forecasters estimate that the plan may trim up to 2 percentage points off annualised growth in the remaining two quarters of the fiscal year. These estimates, though, may be a little too pessimistic. Ben Bernanke, the chairman of the Federal Reserve, has testified to Congress that even cuts of that size should not trim more than a few tenths of a percentage point from growth.

Under different circumstances the economy could weather the political storm, but global markets are generating their own headwinds. Continuing unrest around the Middle East threatens to disrupt oil supplies even as global recovery boosts petroleum demand. As a result of the uncertainty, oil prices rose by about $10 a barrel in February. Macroeconomic Advisers, a consultancy, estimates that a $10 increase, if sustained, could trim 0.2 to 0.3 percentage points from growth this year.

Despite all this, America's recovery is getting stronger. February brought news of faster manufacturing activity and rising consumer confidence. But Americans have learned to expect setbacks. In that, at least, 2011 is unlikely to disappoint.

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Murder in Arizona

Too far gone

The implications of a death sentence on a female vigilante

GINA GONZALEZ was at home with her husband, Raul Flores, and their daughter when the intruders arrived. They said that they were immigration officials, and forced their way into the house. Then the intruders drew guns and opened fire. Ms Gonzalez played dead and later called the police. By the time they arrived Mr Flores and Brisenia, aged nine, had died.

The suspects were quickly apprehended: two men and a woman, Shawna Forde. The men will stand trial later this year, but on February 22nd a jury in Arizona gave Ms Forde the death penalty, a sentence rarely imposed on women.

The sentence for Ms Forde reflects the brutality of her crime. The jury heard that she would rant against undocumented immigrants, and brag that she would change America. Anti-immigrant rhetoric has been heated in recent years, nowhere more so than in Arizona. But Ms Forde was too erratic even for the angry fringe. She had been ejected from the Minutemen, a self-appointed border patrol group, and started her own splinter group, the Minutemen American Defence Fund. She and her co-defendants were hoping to find drugs at the Flores's house, according to the prosecution, so they could sell them and use the proceeds to fund their campaign.

Ms Forde's lawyer argued that this was bluster. Before sentencing, her defence also explained that she had been a victim all her life, having suffered abuse while living in foster care, and later working as a prostitute. The jury, composed of 11 women and one man, did not consider this an excuse.

The case has a parallel in that of Jared Lee Loughner, a gunman who allegedly killed six people in Tucson on January 8th and injured 13 more, including the congresswoman Gabrielle Giffords. Both were disturbed individuals who seemed to mistake rhetoric-about conspiracy in Mr Loughner's case, vigilantism in Ms Forde's-for calls to action. There is no doubt that Ms Forde, like Mr Loughner, represents an extreme and marginal view. But that is little comfort for many Latinos in Arizona, who see the murders as a tragedy partly brought about by a hostile environment. It was the unsolved murder of an Anglo rancher, roughly a year ago, that galvanised public opinion in favour of Arizona's now-notorious anti-immigration law.

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Lexington

Libya and the Iraq syndrome

Does their caution in Libya show that Americans will make war no more?

"THE spectre of Vietnam has been buried forever in the desert sands of the Arabian peninsula. It's a proud day for America-and, by God, we've kicked the Vietnam syndrome once and for all." That, at any rate, is what Bush the elder believed 20 years ago, shortly after the army he sent to Saudi Arabia booted Saddam Hussein out of Kuwait. But history likes a jest. As Barack Obama ponders whether force should be part of his response to Muammar Qaddafi in Libya, is a new syndrome-an Iraq syndrome, contracted in the same sands of Arabia by Bush the younger-one of the things staying Mr Obama's hand?

Bloody wars beget caution. As after Korea, as after Vietnam, the wars in Afghanistan and Iraq have made Americans battle-averse. In 2005 John Mueller, a professor of political science at the Ohio State University, predicted in *Foreign Affairs* that an "Iraq syndrome" would eventually make America more sceptical of unilateral military action, especially in places that presented no direct threat to it, and less inclined to dismiss Europeans and other well-meaning foreigners as wimps. "The United States may also become more inclined to seek international co-operation, sometimes even showing signs of humility."

A bull's eye for the professor. Against a backdrop of two wars and a surly economy, Mars is no longer ascendant in Mr Obama's Washington. His drones may be zapping Taliban encampments in Pakistan, but Mr Obama always opposed the "dumb" war in Iraq, and much of his own party hates the war he calls necessary in Afghanistan. Having been elected as the anti-Bush, he needs another entanglement in the Middle East like he needs a hole in the head. So although Hillary Clinton, his secretary of state, says that no option will be taken off the table, and America has sent warships nearer to Libya, the emphasis for the present is firmly on diplomacy. On Capitol Hill this week, Mrs Clinton talked about "using the combined assets of smart power" in Libya. In a reversal of the usual pattern, America is said to be pouring some cold water on heated talk in Europe, and especially in Britain, of NATO clearing Colonel Qaddafi's aircraft from Libya's skies.

To the prudent and the pacific, the Iraq syndrome may seem no bad thing. The younger Bush's wars have claimed almost 6,000 American lives and drained the country's finances. It would doubtless be better in future for America to embark on such adventures, if at all, with a clearer view of the costs, less faith in a military "cakewalk" and a more modest view of what force can achieve. But what if this salutary caution turns into an unwillingness to use force at all, even when it is called for by the national interest or on humanitarian grounds? And what if dangerous men come to believe that America will never fight? Saddam thought (and said) 20 years ago that after its losses in Vietnam, America would not risk war to rescue Kuwait. The alacrity with which Ronald Reagan scuttled from Lebanon after the marine barracks bombing in 1983 confirmed this belief that America's aversion to casualties was the superpower's Achilles heel.

As he soon discovered, Saddam was wrong about the Vietnam syndrome. No doubt the Iraq syndrome can be overstated too. During ten years of fighting in Afghanistan, and more than seven in Iraq, America has, after all, proved its extraordinary staying power: it takes a lot for Americans to accept defeat once they have joined battle in earnest. And the public appetite for new encounters, though it has dwindled, has not fallen to zero. Only 12% of respondents to this week's *Economist*/YouGov poll favoured military intervention in Libya, but 38% supported a no-fly zone.

Still, a good deal of the risk-aversion is reflected at the top, where it matters most. At West Point last week, Bob Gates, the defence secretary who took over from Donald Rumsfeld in the Bush administration and whom Mr Obama kept on, said that "any future defence secretary who advises the president to again send a big American land army into Asia or into

the Middle East or Africa should have his head examined." What little war talk Libya has aroused has come from the usual suspects: Senators John McCain and Joe Lieberman, for example, and Paul Wolfowitz, one of the architects of the Iraq war. But even they propose, at most, arming Libya's rebels or enforcing a no-fly zone.

It may be that America would have exercised the same caution in Libya even if it had not been for Iraq. Mrs Clinton may be right that outside support for the uprising would be counter-productive. But Iraq has surely coloured other decisions America has taken in recent years, not only on Mr Obama's watch but also on his predecessor's. Bill Clinton (before Iraq) used air power in the Balkans, but Mr Bush (after) did not intervene in Darfur even during the massacres by Sudan's government-supported *janjaweed* militia. He refrained from military action against Iran's nuclear installations, and by all accounts told Israel to hold back too.

The loop and the underlying constant

One interpretation of America's attitude to war is that it is stuck in a loop. Successful ventures with low casualties (such as the first Gulf war or the early, misleading, stages of the Afghan war) breed hubris and further adventures. Costly engagements such as Korea, Vietnam and Iraq then breed caution.

That view is over-simple. Mr Mueller, the predictor of the Iraq syndrome, notes that apart from a mild rise in isolationism after the Vietnam war and a brief drop after the first Gulf war, changes in sentiment have been fairly modest. In general, Americans will tolerate high casualties to ward off what they see as direct threats, such as communism in Korea or Vietnam, or terrorism after 9/11, but almost none to police distant and seemingly perennially troubled countries, such as Somalia (where 18 American casualties in one firefight in 1993 put paid to America's mission). What that means for the democrats of Libya remains to be seen.

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Bolivia's Evo Morales

The calle gets restive

Inflation, shortages and scandals have caught up with Latin America's hitherto most popular leftist leader

UNTIL last Christmas, Bolivia's Evo Morales seemed to be the strongest and most successful of Latin America's far-left presidents. His status as his country's first elected leader of indigenous descent, combined with a policy of funnelling the

proceeds of higher taxes on the oil and gas industry to the poor majority in highland Bolivia, brought him enduring popularity. Having outwitted the opposition, centred in the eastern lowlands, he easily won a second term in 2009 with 64% of the vote.

Yet suddenly little is going right for Mr Morales. An abrupt decision to remove subsidies on fuels, raising their prices by over 70%, was greeted with mass protests of the kind Mr Morales himself once organised against previous governments. He quickly backed down, but that did not quash discontent. Last month Mr Morales pulled out of an event in Oruro, a highland city previously loyal to him, when he was greeted by dynamite-wielding protesters angry at rises in bus fares and food prices. After the government tried to block the fare rises, bus owners withdrew their vehicles from service on February 25th.

Then came embarrassment when Rene Sanabria, a retired police general who is the government's top drug adviser, was arrested in Panama on February 24th and extradited to the United States on charges of cocaine trafficking. Some officials said that the arrest was revenge by America's Drug Enforcement Administration for its expulsion from Bolivia in 2008. However, the interior ministry had three other police officers arrested. Both coca and cocaine production have risen in Bolivia in recent years, according to the United Nations.

But the main headache for Mr Morales is the economy. The government's abortive attempt to remove the fuel subsidy (which cost $380m last year) was a sign of its more straitened finances. Its spending continues to grow, but the short-term boost to its coffers from the tax increase on oil and gas seems to have run out. The state oil company lacks the means, and multinationals the will, to invest much in expanding natural-gas output. Luis Arce, the finance minister, says that the government last year posted a fiscal surplus for the fifth year running, but others doubt that. According to Jaime Perez of Fundacion Jubileo, a think-tank, the government went into the red in 2009. The government itself forecasts a fiscal deficit of around $870m (4.2% of GDP) this year, high by regional standards.

Another sign of trouble is inflation, which has surged to 8.4% over the 12 months to January. Food prices have shot up, and there is a shortage of sugar and other staples. Higher world prices are partly to blame. So are drought and wildfires last year which hurt crops. Flooding this year, which killed 39 people, has caused further disruption to food supplies.

But government policies have made matters worse. As prices rose in 2008 the government intervened to curb farm exports and imposed price controls. The result was that farmers planted less. Huge queues have formed at state food-distribution centres. Some of those centres closed when they ran out of supplies or their staff feared violence. Journalists found food stockpiled at the homes of several government officials and leaders of Mr Morales's Movement to Socialism (MAS) party.

Although the fuel-price rise was withdrawn, it prompted other price rises across the economy, many of which have not been reversed. Bus owner-drivers in particular are feeling the pinch. Fares have been frozen for more than a decade even as the cost of maintaining vehicles and paying police bribes has spiralled. "When I started ten years ago lunch cost two bolivianos, now it costs me eight," says a disgruntled driver.

All this has taken a toll on Mr Morales's popularity. A poll taken in Bolivia's main cities in February by Ipsos-Apoyo showed his approval rating at just 32% (rural areas tend to be more loyal). The government faces little threat from the formal opposition, partly because some of its leaders have chosen exile in the face of legal harassment. Rather, the main source of the president's new difficulties lies in his own movement. The MAS is a coalition of far-left parties, indigenous activists and NGOs. Social movements, such as unions and peasant groups, form its political base.

Until this year such groups believed Mr Morales was on their side, and forgave his verbal snafus and missteps. Now many of them will no longer give him the benefit of the doubt. The government's new slogan is "Governing [is] obeying the people." Having led the Bolivian street for the past decade, Mr Morales now finds himself ruling at its mercy.

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Cuba and the internet

Wired, at last

The battle of the blogs begins

Still a long wait to log on

ACCORDING to government figures, only 3% of Cubans frequently use the internet, making the communist island the least connected place in the Americas. Those that do require patience: according to an industry survey, Cuba's dial-up internet access is the world's second-slowest, after Mayotte, a French territory in the Indian Ocean. Under the guise of rationing the use of bandwidth, internet access is banned in most private homes and censored in offices.

For this sorry state of affairs, Cuba's authorities have long blamed the United States' trade embargo. They have a point. Although a fibre-optic cable, capable of carrying heavy data traffic, runs tantalisingly close to the island's northern coast, George W. Bush's administration blocked a proposal by AT&T to hook Cuba up to it. In 2009 Barack Obama authorised American companies to provide internet services to the island. But Cuba showed no interest in exploring the possibility. Instead it turned to its ally and benefactor, Venezuela.

Last month officials celebrated the arrival of a 1,600km (1,000-mile) fibre-optic cable laid along the seabed from Venezuela by a consortium including France's Alcatel-Lucent and Britain's Cable & Wireless. Venezuela's government has put up the $70m it cost (including a second link from Cuba to Jamaica). Once fully connected in a few months' time, it will raise data-transmission speed almost 3,000 times.

So will Cubans now have free access to the internet? The government has no fear of that, insisted Jorge Luis Perdomo, the deputy-minister of information. Yet last month it charged Alan Gross, an American arrested in 2009 for distributing satellite gear for accessing the internet to Jewish groups in Cuba, with spying. Mr Perdomo says that Cuba simply lacks the cash to install the necessary computers and routing gear. Nevertheless, it recently found $500m as an upfront payment to buy out an Italian group which had formed a joint venture with the state telecoms firm.

Officials know that they face a small but active band of critical bloggers. In practice, the government has found it impossible to block access to the internet completely. Many Cubans bypass curbs by buying internet accounts on the black market. The loophole they exploit is that senior managers, doctors and some academics are permitted home internet accounts. Some use this perk to supplement their state salary of $20 a month by selling their usernames and passwords for around $30 a month, often several times over.

In a video circulating in Havana, probably leaked by the government, an official promises to fight back against the American government's use of social-networking sites to promote dissent. "They have their bloggers and we have our bloggers," he says. "We will fight to see who is stronger." Recently, for the first time in three years, Cuban internet users could access the website of Yoani Sanchez, an opposition blogger. Along with her many supporters abroad, a handful of government backers have taken to posting their hostile comments. A virtual battle has begun.

Canada's lumber industry

If you go down to the woods

You'll find a Chinese surprise

WHEN the United States and Canada first began arguing about lumber, Ronald Reagan had just taken office in Washington, DC, and Pierre Trudeau was prime minister in Ottawa. Three decades later the two countries are still at it. In January American trade officials asked a London arbitration court to penalise exports from British Columbia, Canada's main source of lumber, for subsidies stemming from the underpricing of timber harvested from public lands.

This is an old-and unproven-claim, and such filings have sometimes led to the United States imposing countervailing duties. This time the huffing and puffing was met by a nonchalant shrug. What has changed is that for British Columbian lumbermen the United States is no longer the only game in town. Asia has become an alternative.

Last year British Columbia's timber exports to China totalled C$687m ($667m), a tenfold increase from 2003. Over the past three months total sales to Japan and China exceeded those to the United States. Whereas five years ago more than two-thirds of shipments went across the border, now barely more than a third do. The industry forecasts that by 2013 China will be its biggest market.

That is just as well. Protectionist measures and the collapse of the American housing market have ravaged what used to be British Columbia's biggest employer and export earner. With sales to the United States dropping by 58% from their peak, mills have closed, thousands of workers have been laid off and companies have bled money. "It was the worst and longest...period of decline our industry has ever experienced," according to John Allan, an industry leader.

But over the past two years 24 mills have reopened and 10,000 workers have been rehired to fill orders from China. That is the pay-off for a marketing effort involving the industry and government: Canada has helped to revise China's building codes, set up colleges there to train workers in timber-frame construction, and forged ties with distributors.

So British Columbians have greeted the latest American complaint with insouciance. American officials grumble about a big increase in timber classified as "salvage grade", which attracts minimal cutting fees. The Canadians retort that much of the increased harvesting of timber is a result of the havoc wrought by the mountain pine beetle, which has infested and killed about half British Columbia's commercial pine forests. Furthermore, the system for grading timber was agreed on by the two countries in 2006, when they settled their previous spat over softwood lumber.

Although the American market will one day regain importance for British Columbia, "the time is past when we pretty well had to take what the Americans offered," says Pat Bell, the province's forests minister. Deep in the woods, a new world order has emerged.

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Correction: Brazil's fiscal policy

Our article on Brazil's fiscal policy ("How tough will Dilma be?", February 19th) said that Brazil's economy shrank slightly in 2008, and that government loans and tax breaks stopped it from contracting even more. Both statements should have referred to 2009, not 2008. Sorry. This has been changed online.

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Another political assassination in Pakistan

Things fall apart

With the rise of militant Islam, Pakistan reaps what for years the state has sown

ON MARCH 2nd came the second high-profile political murder in Pakistan in two months. Shahbaz Bhatti, the minorities minister, seems to have been killed for the same reason that Salman Taseer, the governor of Punjab province, was assassinated on January 4th. Both had called for the harsh law on blasphemy to be changed. After Mr Taseer's death, Mr Bhatti, a Christian, was a rare prominent politician to condemn the governor's murder. He was only too aware of the risks. But, he said, his faith gave him strength.

What is loosely known as the "Punjabi Taliban" immediately claimed responsibility. It is an assortment of Muslim extremist groups, some of whom in the past have had the help of the army's undercover arm, the Inter-Services Intelligence (ISI), in waging a low-level guerrilla war in Indian-occupied Kashmir. The Punjabi Taliban are now distinct from that lot.

Yet people are not inclined to take things at face value. The ISI itself is widely believed to be responsible for everything from the assassination of Benazir Bhutto in late 2007 to the rise of fundamentalist chat shows on cable television. But in terms of conspiracy theories, the ISI can give as good as it gets. Hamid Gul, a former head, says Mr Bhatti's killing is "another Raymond Davis-style attack", referring to the row between America and Pakistan over a CIA contractor who killed two Pakistanis (see article). The Americans, Mr Gul says, want to destabilise Pakistan so that they can somehow make the case that Pakistan's nuclear weapons are not safe in Pakistani hands. "This is a tried and trusted intelligence tactic. I should know."

Others recognise the Punjabi Taliban as a Pakistani phenomenon-one of the consequences of a rising tide of Islamic fundamentalism which manifests itself in increasingly violent ways. Indeed, today's crisis has been long in the making. Over three decades, political and military leaders have appealed to Islam as a source of strength. Zia ul Haq, the military dictator who ordered the killing of Bhutto's father (Zulfikar Ali Bhutto, a former president and prime minister), introduced *sharia* law, favoured Islamist political parties and promoted orthodox Muslims in the armed forces and bureaucracy.

Decades of conflict in Afghanistan have pumped guns into Pakistan, and foreign money has funded extremists. In the 1980s American and Saudi support for the Afghan resistance to Soviet occupation engendered conditions that later fostered both the Afghan Taliban and al-Qaeda, with consequences for Pakistan today. All the while, money has been flowing into Pakistan from the Arabian Gulf to support a hardline version of Islam, pushing back Pakistan's more tolerant Sufi-based form. Raheeq Ahmad Abbasi, of the Tehreek Minhaj-ul-Quran, a non-sectarian Muslim body, says that of around 20,000 madrassas in Pakistan roughly 15,000 promote hardline doctrines.

None of this would have mattered so much had Pakistan's governments performed better. But the failure of both civilian and military rule to provide decent education, health care or robust levels of economic growth has fed frustration among the young. In Pakistan, where the politicians have governed no better than the soldiers, democracy has only intermittent appeal as a rallying cry.

Religion appeals more; hence the spread of militant Islam. At its violent extreme is a network of Islamist terrorist organisations which, according to Amir Rana of the Pak Institute for Peace Studies, breaks down into three broad parts. Al-Qaeda provides the ideology. The "Pushtun Taliban" is a loose-knit alliance of groups along Pakistan's north-western border who rose up in opposition to America's war against their ethnic brothers next door in Afghanistan. It provides the logistics and the hideouts. Meanwhile the Punjabi Taliban increasingly provides the foot-soldiers for terrorism. Khaled Ahmed, author of "Sectarian War", a new book on religious violence in Pakistan, says all three elements work closely together.

Pakistan is of increasing interest to al-Qaeda's leaders at a time when they must be disappointed that militant Islam has played almost no part in north African uprisings. In 2009 al-Qaeda's number two, Ayman al-Zawahiri, an Egyptian, produced a book on Pakistan's constitution entitled "The Morning and the Lamp". It argued that the state was illegitimate and should be destroyed. Mr al-Zawahiri is widely believed to be lodging with the Pushtun Taliban. The Pakistani army allowed the networks to flourish for a while, because they supported the Afghan Taliban, ISI allies. But in 2009, pressed by America, it pushed them out of their strongholds of Swat and South Waziristan and into the remote badlands of North Waziristan, where they have been left to their own devices.

The Punjabi Taliban grew out of a combination of ISI support for anti-Indian militants, anti-Shia feeling in central Punjab and Gulf money in south Punjab. Southern Punjab, a favourite area for rich people from the Arabian Gulf, is now thick with well-funded religious institutions. Mr al-Zawahiri's tract has been widely distributed in seminaries there.

The Punjabi Taliban poses a greater threat to the Pakistani state than does the Pushtun Taliban. Three-fifths of Pakistanis live in Punjab. The province is the army's main recruiting ground. It could not carry out the sort of operation there that it mounted in Swat and South Waziristan.

Foreigners looking nervously at this nuclear-armed state wonder whether militants who murder ministers might one day take over the government. That seems highly unlikely. The country's political system may be weak, but its bureaucracy and armed forces are strong, and they would not allow it. However, although Pakistan's state is not going to be overthrown, the country's nature is changing.

Until recently, Pakistan was a joyfully argumentative and outspoken place. Now Pakistanis are falling silent. Only one among a group of academics and students at the University of Punjab discussing the fundamentalists' control of the campus was prepared to be named. When asked why the university had organised no ceremony to mourn Mr Taseer, who was its chancellor, Samee Uzair Khan, an assistant law professor, said: "If somebody as big as Salman Taseer can be killed, how can we be safe?"

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America and Pakistan

Stuck with you

A clash between spy agencies is boosting the ISI-but is doing Pakistan no favours

Raymond Davis: the popular verdict's in

CHALK up one point to Pakistan's military-intelligence service, the ISI, and none to America's. In a test of strength over the fate of an American agent, awaiting trial for murder, it is clear who is emerging the stronger. The agent is Raymond Davis, whom America now admits worked in some way for the CIA. He shot and killed two apparent robbers on a motorbike, in a busy street in Lahore in late January. An American driver, perhaps working for the CIA, then accidentally killed a third man while rushing to the scene. A little later the despairing wife of one of the victims committed suicide.

That miserable run of events has left ordinary Pakistanis furious. Mr Davis is such a figure of hate as he languishes in a Lahore jail that even his guards are kept unarmed for fear they might kill him. Anti-Americanism, always high, is soaring.

Had Pakistan wished, Mr Davis might have been quietly whisked away. The Americans, from Barack Obama down, say he has diplomatic immunity. That seems wrong-Mr Davis's name was not put on a diplomatic list until after he had fired his shots. But Pakistani officials might once have gone along with the fiction. The civilian government probably wanted to do so. Asif Zardari, the president, had been hoping to go to Washington this month and craves a visit to Pakistan by Mr Obama. He needs American and IMF cash to prop up a failing economy.

Yet Mr Zardari was too weak to let Mr Davis go. Political rivals grabbed a tempting stick with which to bash his derided government. In Punjab an alliance between his party and the opposition has crumbled, a sign that parties may be preparing for an early national election.

More important, the ISI made sure that Mr Davis could not be released. It briefed journalists on American lies about his immunity, helping stir public anger. The press made lurid claims that the American had been trying to plant evidence that terrorists have nuclear-weapons material, as an excuse for outsiders somehow to seize Pakistan's treasured nuclear arsenal.

For the ISI, the Davis incident is a godsend. It is furious with the way American agents work independently, tracking al-Qaeda, Taliban and other militants who have slipped into Lahore and Karachi to flee drone attacks on the mountainous border with Afghanistan. This may have been the work Mr Davis did-snooping around *madrassas*, trying to contact anyone connected to extremists.

The Americans say they act alone because the ISI fails to co-operate. For example, after the CIA found Abdul Ghani Baradar, an Afghan Taliban leader, in Karachi in February last year, the Pakistanis put him under house arrest but are said to have limited American access to him. More intriguing-though stoutly denied by the ISI-was a *Washington Post* claim that the ISI brought Mullah Omar, the leader of the Afghan Taliban, to Karachi on January 7th for an emergency heart operation.

As relations soured, Pakistani intelligence, which already feels humiliated by America's widespread drone attacks against the Afghani Taliban on Pakistan territory, tried blocking the arrival of American agents by vetoing visa requests. The Americans (and Mr Zardari) responded, last year, by arranging for Pakistan's embassy in Washington to hand out visas independently. Dozens of American contractors reportedly flocked into Pakistan.

Furious, the ISI targeted the CIA, leaking the name of the station chief to the Pakistani press in December and so forcing him out. American intelligence in turn briefed friendly journalists that the ISI was responsible for the leak. Most strikingly, the ISI is now rumoured to be behind efforts to arrest more Americans. Aaron DeHaven, with connections to the security industry, was detained in Peshawar in late February for overstaying his visa. Leon Panetta, the CIA head, calls the fraught ties with Pakistan "very complicated".

Bruce Riedel, author of a new book on America and Pakistan, concludes that "the stakes are enormous and they are all going to hinge on the fate of one man", Mr Davis. A few options for reconciliation are open, but none looks appealing to the Americans. Most obvious, as the ISI sees it, is for America to back down and let the ISI oversee the snooping on Islamic extremists, in effect ceding a veto on whom to target.

Strong differences exist, for example in North Waziristan over the militant Haqqani network, considered a friendly group by the Pakistanis but a terrorist threat by the Americans. Similarly, attitudes differ towards Lashkar-e-Taiba, reckoned by Pakistanis to be a useful tool for threatening India, but an international terrorist group by Americans, especially since an attack on Mumbai in November 2008.

Next the ISI wants the American government to discourage a private court case in New York against past and present chiefs of Pakistani intelligence. The suit, brought by American victims of the Mumbai attack, claims the ISI directly helped the terrorists, but perhaps America could say that Pakistani spy leaders enjoy sovereign immunity

Last, and perhaps least appealing of all to the Americans, Pakistan's spies want more say on efforts to end the war in Afghanistan. Whether any of these, or other, concessions will be made for the sake of a difficult relationship is unclear. But an ISI officer this week happily suggested that "sanity is prevailing".

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Jasmine stirrings in China

No awakening, but crush it anyway

The government goes to great lengths to make sure all is outwardly calm

Meet the goons

AT SOME point in the education of every foreign student of Chinese, joining a chorus of the simple and syrupy song "Beautiful Jasmine Flower" is all but mandatory. A bunch of students in Kenya sang it to Hu Jintao in 2006, as the Chinese president clapped along, a scene recorded by China's state-run broadcaster. Until recently that clip was available

on Chinese video-sharing websites. Now it has been removed. Googling the folk song's name produces an error message, indicating that it is blocked by China's internet firewall. As China ratchets up security to stop contagion from Arab uprisings, even this folksy song, a theme tune at the Beijing Olympics, has become newly taboo. China's leaders have the jitters.

The Communist Party is going to extraordinary lengths to prevent stirrings of a Tunisian-style "jasmine revolution" in China. Beijing is gearing up for the annual session of the country's legislature, the National People's Congress (NPC), on March 5th. Security is always tight for this event, which runs for less than two weeks. Every year the authorities worry that the disaffected will use the session as a pretext to air grievances. But the unrest in north Africa and the Middle East, and calls on the internet for copycat protests in China, have made them especially anxious. Officials insist that the Chinese have no desire to protest. Their clampdown suggests they believe otherwise.

On February 20th and again a week later the police mounted huge security operations in Beijing, Shanghai and several other cities, after the circulation of microblog messages urging citizens to take part in silent walk-pasts on those days. Barely anyone did. Police pounced on the handful who looked so inclined and whisked them away. Dissidents have been detained or put under heightened surveillance. Several people accused of circulating internet calls for protests have been charged with endangering state security.

Foreign journalists have also been summoned by the police and given warnings not to go to the designated protest areas without permission. This has not been granted, at least for would-be protest times. An American journalist was beaten and kicked by plain-clothed goons and detained for several hours while attempting to report in one such spot in Beijing's central shopping district. Several others were turned away or physically harassed by police, prompting objections by American and European officials.

The NPC session comes at a difficult time for the Chinese government, with many citizens unhappy about rising food and housing costs. On the agenda is a new five-year economic plan meant to help China wean itself off investment and exports and rely more on consumption to drive growth. Something similar was attempted five years ago, but household incomes and consumption have grown more slowly than has the economy overall. Officials worry that a widening gap between rich and poor threatens stability.

Chinese leaders stress how hard they are trying to keep prices in check and to look after the needy. In an online "chat" with internet users on February 27th (now standard before the NPC meeting), the prime minister, Wen Jiabao, promised the construction of 10m low-cost subsidised homes this year, 70% more than in 2010.

Mr Wen also suggested he would rein in an investment boom in the provinces that has been fuelling inflation. The government, he said, would aim for annual GDP growth of 7% in the next five years, compared with a target of 7.5% set for 2006 to 2010 (when growth, in fact, averaged more than 10% a year). But *Caixin Weekly*, a Beijing magazine, reports that provinces still vie with one another to boost their GDP figures with the help of big investment projects. Many have set targets far higher than Mr Wen's.

For all its nervousness, the Chinese leadership is a collective affair: no hated Mubarak or Qaddafi figure serves as a lightning-rod for discontent. Top leaders even favour occasionally exposing egregious corruption among their subordinates. In recent days the official media have reported a huge alleged bribery scandal involving the railways minister, Liu Zhijun, who was sacked last month. The ministry is a safe target, given widespread public complaints about overcrowded trains and corrupt ticketing.

As for the NPC itself, do not expect dissent. Its nearly 3,000 delegates are hand-picked. "Debate" consists mainly of delivering speeches in support of government policy. Jasmine is present, if at all, only in endless cups of tea.

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China's rescue mission to Libya

Push factor

The armed forces nudged farther afield

FOR a fast-rising power, China is shy about military deployment beyond its borders. But its decision to dispatch four military transport planes to Libya and a guided-missile frigate to waters nearby suggests a rethink of its posture.

On March 2nd one of the four planes ferried 250 Chinese in Libya to Sudan's capital, Khartoum. The ship, *Xuzhou*, which had been on anti-piracy duties in the Gulf of Aden, arrived on the same day.

These efforts are more symbolic than anything. Of 30,000-odd Chinese in Libya when the unrest began, all but about 1,000 seem to have left the country before the deployments began. Still, they are a sign that the Chinese armed forces have gained confidence since the dispatch in December 2008 of a small flotilla to join international operations against Somali pirates.

The anti-piracy mission was the navy's first active-duty assignment beyond East Asia. China has long been wary of stirring fears about its growing military capabilities, as well as of revealing frailties to potential enemies, America in particular. The Libyan deployments are best understood as responding to domestic pressures. For the government to show little concern for Chinese lives in Libya would have gone down poorly at home, especially among the country's fiery online nationalists.

A similar calculation was at work with China's unusual vote on February 26th in favour of a UN resolution imposing sanctions on Muammar Qaddafi and calling for an investigation into whether he has committed crimes against humanity. Officially, China still abhors what it calls "interference in other countries' internal affairs". But Colonel Qaddafi's control is tenuous, and Chinese lives are at risk. The Communist Party would be lambasted for propping up the man endangering them.

In a blog on the website of *Caijing*, a Beijing magazine, a Chinese journalist suggested that it was time for China to give up the non-interference policy. The article was boldly titled "Support the dispatch of American troops to Libya" and it argued that "human rights come before sovereignty". It said that when "a tyrant enslaves his country and tyrannises and massacres his citizens" talk of non-interference is so many "dog farts". The party might not put it quite like that.

Meanwhile, Chinese leaders have noted lumbering attempts by India, the region's other rising power, to rescue its citizens trapped in Libya. By March 2nd only a quarter of the 18,000 Indians in Libya were safe, mostly rescued by civilian airlines and cruise ships chartered by the government. Three Indian naval ships have also been sent to help, though they were not due for some days. Two military transport planes were being prepared. For good measure, the foreign ministry boasted how many committee meetings had discussed the evacuation. The authorities bristle at any comparison with others' quicker responses. "We are not in competition with China here," tweeted an angry Indian foreign secretary, Nirupama Rao. "Please do not devalue this."

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India's economy

Calling on the gods

The finance minister gushes with optimism, but how much is warranted?

PRANAB MUKHERJEE, India's finance minister, is full of beans. His budget on February 28th drew praise from some observers for not being too lavish despite big state elections due next month. Chuckling over it the next day, he said the economy was in fine shape. Getting 9% growth "plus or minus" in the coming year will be a cinch, at least if the monsoon comes on time. "I require only the blessings of a god and a goddess."

It is tempting to expect the gods to keep smiling. Only China, among big economies, has pipped India's 8.6% growth in the past year. Mr Mukherjee foresees a rosy period of easing inflation, reviving foreign investment and robust public finances. He may be in for a shock.

Inflation is still a pressing problem. High food prices hurt the urban poor. In December street protests over the price of onions led the government to ban their export. Onion prices have since collapsed, but other causes of inflation remain.

Cash is pouring into rural areas through a make-work scheme, named after Gandhi. This will expand as Congress, the party at the head of the government coalition, tries to ease dire poverty in villages, where most voters still live. Benefits will flow faster as cash transfers replace clunky subsidies for fuel and fertiliser. Pilot schemes for this will start early in 2012, and may be speeded as Indians are issued with identity cards, in a separate initiative.

Social spending is set to leap by 17% next year, as the government attempts to encourage "inclusive" growth. Congress's chief, Sonia Gandhi, next wants a law embodying a universal "right" to food. How this might work (if at all) is unclear. Again, technocrats favour transfers of cash or vouchers over dishing out food through a vast and corrupt state bureaucracy. Either way, the subsidies mean demand for food will soar.

No matter, says Mr Mukherjee breezily. By spending on agriculture, giving farmers credit, easing transport bottlenecks and getting better cold-storage distribution, supply will rise, too. As for other causes of inflation, seven interest-rate rises by the central bank have removed monetary excess, he says. Little can be done about painful world prices for oil and other commodities, but, barring a big shock, Mr Mukherjee guesses annualised inflation will drift down to about 6% in a year's time, from nearly 10% today.

If that sounds a stretch, so do claims that investors will crowd back. Foreign direct investment in 2010 fell to $21 billion, from $27 billion in 2009, even as it grew elsewhere in Asia. Overseas portfolio investors who once raved over India's stockmarket have pulled out $2 billion in the past couple of months, reflecting fears of overheating.

Investors, local and foreign, complain that the environment minister has blocked good projects. They grumble that fine talk of opening up retailing and other industries leads to no action. Two decades ago the then-finance minister, Manmohan Singh, began scrapping regulations and unleashing growth. Today, with Mr Singh in his second term as prime minister, the government looks timid.

Ministers retort that they continue to liberalise. Promised financial reforms, if passed (earlier efforts lapsed), could eventually let outsiders play a bigger role in insurance and lend more for new infrastructure: $1 trillion is to go on new roads, rail, ports and so on in the next few years, nearly half to be funded privately. This money would go further if land acquisition were less corrupt and chaotic. Delhi's swanky new airport train, a public-private project, was delayed for months in part by wrangling over land. Mr Mukherjee admits there is a problem, and talks hopefully of the "expeditious" passing of a land-acquisition act. That seems unlikely.

Reform may yet roll, in the form of a long-planned general-services tax. From June, 11 states will launch their first attempts. Next year, if the opposition backs it, the whole country will get the tax. That would help to reduce a budget deficit that is now over 5% of GDP. So would getting more people to pay income tax: a raid by gleeful tax inspectors on Bollywood starlets in January attracted lots of attention. But if such efforts are delayed, the government will have to adopt other devices to patch up the public finances. It used billions from a one-off auction of 3G telecom spectrum to plug budget gaps this year. It promises to sell more chunks of state-owned businesses, presumably in order to fill holes in the year to come.

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Banyan

More black tea than jasmine

Watching the Middle East and north Africa, Central Asia's rulers see no pressing reason to fret

LONG-SERVING dictators accused of corruption and nepotism; pervasive, cruel security forces; dissenting voices silenced in the name of the war against Islamist terrorism; worries about rising prices and jobless, rebellious youth; embarrassed Western friends ready to overlook a spot of repressive dictatorship and focus on the massive resources and strategic location. Even the stolidly pragmatic rulers of the Central Asian republics spawned by the disintegration of the Soviet Union must see familiar themes behind the jasmine revolutions. None, however, is yet quaking in his boots. Central Asian autocrats, they seem to think, do it better.

Nursultan Nazarbayev has ruled Kazakhstan and Islam Karimov Uzbekistan since 1989. Emomali Rakhmon has run Tajikistan since 1992. Turkmenistan's dictator, Saparmat Niyazov, who styled himself Turkmenbashi, or "head of the Turkmens", died in December 2006. Shorn of his personality cult, his successor, Gurbanguly Berdymukhamedov, has tinkered a little at the margins of despotism, but has adopted a similar isolationist, autocratic style. Only Kyrgyzstan has seen revolution since 1989, and it has done so twice-once in 2005 when a popular uprising deposed Askar Akayev and installed Kurmanbek Bakiyev, and once last year when a popular uprising deposed Mr Bakiyev and installed the region's first experiment in parliamentary democracy.

The other "stans" are all strongman regimes of varying viciousness. Uzbekistan, the most populous, is also perhaps the most brutally ruled. Its spies have a grim reputation for torture. But all the regimes restrict the freedom of speech, hound their opponents and fix elections. All also preside over monumental corruption. In the 2010 Corruption Perceptions Index, compiled by Transparency International, all but Kazakhstan are near the bottom of the global league table. And even Kazakhstan, at 105 out of 174 after a surge up the table, ranks below Tunisia and Egypt.

Nepotism clouds the links between government and business. In Kyrgyzstan the lucrative dealmaking of Mr Bakiyev's son contributed to his father's downfall. One of Mr Nazarbayev's sons-in-law was sacked as ambassador to Austria in 2007, accused of kidnapping, involvement in organised crime and money-laundering; another, a leading light in the oil-and-gas industry, is sometimes tipped as a possible successor to Mr Nazarbayev. Mr Karimov's rich and powerful daughter is said to be the most hated person in Uzbekistan.

Few, however, expect to see huge protesting crowds gathering soon on the streets of Ashgabat, Astana, Dushanbe or Tashkent. Despite the political similarities, the region feels distant from the Middle East and north Africa. Its peoples mainly speak Turkic languages (Tajiks speak Farsi) and have large ethnic-Russian and other minorities. If they follow trends elsewhere, it is to Turkey or other former Soviet republics that they are more likely to look for pointers. The "colour" revolutions in Ukraine and Georgia probably caused more nail-biting among their leaders.

Moreover, access to the internet, so important in Egypt, is heavily curtailed in much of the region. Bloggers did play a part in Kyrgyzstan's upheaval last year, but outside the cities few Central Asians have computers. In Uzbekistan connections are poor and expensive, social networks such as Facebook and Twitter are hardly used, and sites the government does not like, such as the BBC's, are blocked. The moderator of one online forum popular among Uzbek exiles recently urged users never to open the site inside the country, after some participants were arrested.

Recent history is a further deterrent to rebellion. Unrest in the town of Andijan in Uzbekistan in 2005 was suppressed at the cost of a massacre. Few doubt Mr Karimov's readiness to repeat the remedy. After a five-year civil war that ended in 1997, Tajikistan has an abiding fear of chaos and violence. And even the successful uprising in Kyrgyzstan last year is seen elsewhere as a negative example. Not only was it bloody and chaotic itself; it was followed by dreadful ethnic conflict in the south of the country. One of the pretexts for authoritarian rule has always been the potential for this sort of bloodshed in a region where ethnic composition was jumbled by Soviet-era borders and migration.

Central Asia's autocrats may actually feel stronger than they did two months ago. Some regimes profit from the surging oil price, which also gives them even greater clout as they resist any pressure from the West to make political reforms. That pressure, from America at least, is already tempered by the role Kyrgyzstan, Tajikistan and Uzbekistan play in the war in Afghanistan. As relations with Pakistan languish, Central Asia looks even more important as a conduit for supplying coalition forces.

How to say goodbye

There are some signs of nervousness, though. Even Mr Nazarbayev, who might well win an election in Kazakhstan even without the usual precaution of denying the opposition a fair chance, has called a snap election rather than have his rule prolonged until 2020 by a referendum, as had been the plan. Some see this as a reaction to Western disapproval of the referendum. Others see a direct response to events in Egypt.

One reason for calling the election early, rather than simply ditching the referendum, may be concern about the economy-notably rising prices. It is true that, across the region, an economic downturn may be the most serious short-term threat the governments face. A particular worry is that Russia might curtail access for migrant workers, cutting off a lifeline for many in the region. And despite the appearance of political calm, these are brittle regimes. After all, the leaders of Kazakhstan, Tajikistan and Uzbekistan all face a problem that flummoxed their counterparts in Egypt, Libya and Tunisia: how to remain guarantors of stability, and not the main threats to it.

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Libya

A civil war beckons

As Muammar Qaddafi fights back, fissures in the opposition start to emerge

WHAT began as a more or less peaceful uprising is set to degenerate into a full-scale civil war. After losing a string of cities on all sides of Tripoli, his capital, Colonel Muammar Qaddafi is fighting back. The coastal strip on Libya's east side remains firmly under control of the rebels, with their headquarters at Benghazi. The rebels beat off the colonel's forces in their attempt to recapture Brega, an oil town west of Benghazi (see map). But the Libyan leader seems determined to retake some of the towns closer to his capital and has sent his aircraft to bomb targets in a swathe of rebel-held areas.

Meanwhile Western and Arab leaders pondered whether, if the bloodshed worsens, they should enforce a no-fly zone over the country in an effort to isolate and bring down the colonel (see article). The rebels, unsurprisingly, are keen on the idea. For the moment, the Americans sounded wary. The Arab League said it was not against it in principle, provided the Arabs and the African Union gave a green light. Venezuela's president, Hugo Chavez, a friend of the Libyan leader, aired a peace plan, which few seemed likely to take seriously. As the battle intensified, speculation grew that outsiders might become more involved. American battleships assembled off the coast, while global jihadists eyed their chance to get embroiled.

In any event, the rebels' heralded push to the west has slowed right down. Impatient rebel sons are begging their fathers to let them march on Tripoli; some 17,000 have signed up as volunteers in Benghazi alone. But it is unclear who is in charge. Civilian leaders, saying they must call the shots, mistrust the rebel soldiers, especially those bearing the rank of colonel, who question the civilians' capacity to command. Standing on a balcony above the entrance to Benghazi's court-house, now the rebel headquarters, an elder tells a champing crowd to expect a long struggle.

Moreover, Colonel Qaddafi still commands a band of tribal support, running down through central Libya from Sirte, where his own clan is based on the Mediterranean coast, south through the tribal lands of Oulad Suleiman to Tuareg territory near the border with Chad. "We're facing a stalemate," says a banker-turned-opposition leader in Beida, a

conservative religious and tribal centre in the Green Mountain, north-east of Benghazi. The rebels' priority is to fortify and hold on to Ajdabiya, a gateway between east and west.

Libya's tribes are in a state of flux. Elders from the Zintan tribe, south-west of Tripoli, which has traditionally been allied to Colonel Qaddafi's, have broadcast a statement on a satellite channel aligning themselves with the rebels. But Libya's largest tribe, the Warfalla, with nearly 1m members (in a total population of nearly 7m), remains nervously part of a federation loyal to the colonel. Its members still fearfully remember the bloody punishment they got after backing an abortive coup in 1993. "Their elders still refuse to talk to us," bemoans a rebel leader from Beida.

The civilian opposition may be doing better than the armed one. Since breaking free from the Qaddafi regime in the east, young men with paintbrushes have been whitewashing the police stations they previously torched and urging policemen to return to their posts. Others have repainted shutters on shops, which the colonel's officials required to be a monochrome green. ("He made us hate green," says one.) The rebels have started a newspaper, replacing the official Libyan calendar dated from the Prophet Muhammad's death with the Gregorian one that all Libyans understand. Merchants in Benghazi's gold market are tentatively opening their shops.

Cyrenaica, Libya's eastern slice that was once a breadbasket of the ancient world but has since been ruined by the colonel's eccentric economic theories, is re-establishing its trading links. Benghazi's ice market is stacked with donated medicine and food from Egypt. Bankers say their vaults have enough cash to last a good month. Oil-refinery managers say they can still meet most of the demand, despite the disruption caused by the fighting.

In areas in rebel hands, a feared descent into chaos has not materialised. Despite a dearth of policemen, crime has not risen. Female students attending celebrations have not reported harassment. For almost two weeks, restaurateurs have been offering free tea and sandwiches. To display their new-found sense of fraternity, businessmen have helped sweep the streets. "We've defied Qaddafi's claim that chaos would ensue," says Abdel Hafiz Ghoga, an opposition spokesman in Benghazi.

Some migrant workers, without tribes to protect them, have been targeted by rebels. Vietnamese and Filipino nurses have been turfed out of their homes and have fled. But most of the 1.5m foreign workers in Libya from poor countries such as Bangladesh, whose governments were unable to arrange airlifts home, have stayed on. A Scandinavian oil man, who doubles as an honorary consul, has tried to protect dozens of Eritrean labourers cowering in a warehouse for fear they will be mistaken for the colonel's reviled mercenaries, 60 of whom were said to have been massacred in the Green Mountain town of Shahat, after rebels captured them.

The resentful east

It is easy to see why the people of Benghazi have little love for their long-time leader. He is said to call the town *ajouz al-shamta*, "the old hag". Most of its better buildings predate his rule. His plan to demolish the old Ottoman-era markets was stymied by UNESCO, the UN's cultural arm, just before the bulldozers moved in. As a punishment, the colonel removed the city's holiest modern shrine, to Omar Mukhtar, Libya's anti-colonial hero, dumping it 50km (31 miles) to the south. Much of the Ottoman quarter is rutted and swamped in sewage.

But before Libya's economy can be resuscitated, especially in the neglected east, the rebels must rebuild virtually every civil institution and win back the trust of just about every sector of society, from lawyers and doctors to soldiers and farmers.

The protesters came from all walks of life. But the revolt began when lawyers marched on the court-house to complain about the arrest of colleagues who had represented the families of 1,270 Libyans, most of them Islamists and many from Benghazi, who had been massacred by the colonel's men in Tripoli's Abu Salim prison in 1996. But the Islamists and secular liberals, with the shared aim of dishing the dictator, have struck up an alliance.

One early decision of this broad-based rebel movement was to retain the services of the police and to focus their ire on the ruling Qaddafi family. Municipal committees in rebel-held towns were assigned the basic tasks of humdrum administration. At a higher level, an interim "national council" has been formed, with authority over a 13-man military council overseeing the forces that defected from the colonel.

But a coherent government in the liberated zone has yet to emerge. No one is quite sure what laws should prevail. Despite banners calling on Benghazi's merchants to reopen their shops, many are still shuttered. Children have yet to go back to school, despite a deadline for doing so. Many urban Libyans are too frightened to hang the old flag from King Idris's time from their windows lest the military tide flows back in Colonel Qaddafi's favour.

The first big crack in the rebel movement opened when Mustafa Abdel Jalil, who had been the colonel's justice minister until he joined the rebels, took to the airwaves to declare himself head of a provisional government. His credentials seemed sound. He had the backing of the people of Beida, where earlier revolts had broken out. And he had a record of defying the colonel from within government.

But many of Benghazi's lawyers, who had orchestrated the first protests, thought he had jumped the gun-and carped at the prospect of ceding a youth revolution that started in the towns of the coast to a 70-year-old tribal elder from the mountains. A day after Mr Abdel Jalil's proclamation, they nominated an alternative spokesman, another lawyer half his age.

Despite this hiccup, the coalition has survived. Representatives of religious foundations tell journalists they want a mainly secular constitution, not one based on the Koran. A leader of the Libyan Islamic Fighting Group, a global jihadist outfit whose members were let out of prison last year, insist that the organisation, contrary to the colonel's claim, has no truck with al-Qaeda, nor does it seek an Islamic emirate. Benghazi's new council includes both Islamists and westernised merchants, and promises elections within six months.

But at prayer times, differences among the celebrants in front of Benghazi's court-house do emerge. In the front rows a few hundred secular-minded youths cry "Free Libya!" and play Arab pop music over loudspeakers. Behind them, in rows 20 deep, a far bigger crowd chants prayers.

Could a post-Qaddafi Libya reflect a similar division? Based on relationships forged in the notorious Abu Salim prison, a loose Islamist front is emerging. Old-time sheikhs and graduates schooled in Salafi pietism (who seek to emulate the behaviour of the Prophet's comrades) have teamed up with Muslim Brothers who temper their enthusiasm for sharia law with pragmatism in their dealings with non-Muslim people and governments.

The jihadists take a more rigid line, saying they will tolerate anything-as long as it does not conflict with Islam. Muhammad Busidra, a British-trained doctor freed a year ago after 21 years in Libya's jails, who calls himself the jihadists' lawyer, derides the colonel's claim to be the "liberator of creed and faith" but says his ban on alcohol and cinemas should continue. The Islamists grumbled when an American-trained secular professor was given the education portfolio on the new council. Mr Busidra reassured them that it would please their Western helpers and anyway would not last long.

All in all, the Islamists are gaining ground. Mosques, hitherto closed between prayer times to limit public assembly, are open round the clock. The imams have started to preach politics, offering their pulpits to Islamists tortured by the regime. The clerics have also begun to dispense welfare. Salim Jaber, a prominent Benghazi imam appointed to the new council's religious committee, hands out food, shifting its distribution from market to mosque. "The sheikhs will decide who deserves food-and who does not," says an oil engineer helping with the catering.

America has permission to help

So far, both hardline Islamists and secular liberals want the Americans to enforce a no-fly zone over Libya, mainly to prevent Colonel Qaddafi from flying reinforcements of African mercenaries to his base in Tripoli. They also want the West to recognise the national council. And both want a quick end to the colonel's regime. "If we start a guerrilla war, we'll get help from foreign jihadists, and Libya will be another Afghanistan," says Mr Busidra, who wants to keep jihadists out. "International opinion should move." Lawyers, businessmen, Muslim Brothers and former exiles in the national council all say that no measures should be ruled out; the council specifically called on America to raid Colonel Qaddafi's base in Tripoli.

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But others disagree. "We'll stop fighting the tyrant and shoot the Americans instead," says a veteran of Libya's war in Chad, who now mans an old anti-aircraft gun on Benghazi's corniche. Some Islamist leaders say they may face pressure to

fight American troops if they became involved. If the liberals were to endorse Western military ground action, they could soon be pilloried as foreign stooges, thus strengthening the Islamists' hand.

Libyans have a strong jihadist tradition, going back a century to Omar Mukhtar, who conducted a holy war for two decades against the colonising Italians; he lost but remains a heroic unifying symbol. Religious, tribal and nationalist feeling is still strong. More recently, Libyan jihadists have been prominent in Iraq, where, according to a study by West Point's Combating Terrorism Center in 2008, Libyans (nearly all from the eastern part of the country) made up a fifth of foreign jihadists, the second-largest group after the Saudis and the highest per person of any country. Sufian bin Qumu, a rebel leader in Darna, north-east of Benghazi, was once Osama bin Laden's chauffeur.

Yet Libya before Colonel Qaddafi's coup in 1969 combined respect for Islam with friendship towards the West. King Idris's legitimacy rested on his leadership of the Sanussi religious order, whose flag the rebels have made their own. He co-operated with Islamists but let the British and Americans have military bases on his soil.

Most of today's Islamists in Benghazi look to the West for help in rebuilding civil institutions, after decades of military rule. The reopening of the American cultural centre in Benghazi, says Mr Busidra, the jihadists' lawyer, would be rather nice. But it may not happen for quite a while.

Everybody loves me

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Libya's no-fly zone

The military balance

Muammar Qaddafi has enough military power at his disposal to make dislodging him a bloody and uncertain business

WESTERN capitals are holding urgent talks about what help to give Libya's rebels. On February 28th Britain's prime minister, David Cameron, told Parliament he had asked the chief of the defence staff "to work with our allies on plans for a military no-fly zone". But the next day brought cooler talk from America. Robert Gates, the defence secretary, said only that he was sending two naval vessels-an amphibious assault ship, *USS Kearsarge*, and an amphibious dry dock, *USS Ponce*-towards Libya, to provide humanitarian help.

The option of a no-fly zone may yet gain ground, however. Colonel Qaddafi's 18,000-strong air force, with its 13 bases, is critical in his bid to retain power. His use of ground-attack jets may have been exaggerated: they are hardly the weapon of choice for street-fighting. Handier are his 30 or so Russian attack helicopters and transport aircraft. He also has a heavy-

transport helicopter squadron with four Boeing Chinooks, and a squadron of Russian medium helicopters that can serve as gunships.

The colonel's ability to move reinforcements rapidly around his vast country has already helped his fightback. He may have been preparing for this for many years. Unlike the well-equipped, albeit poorly-run, air force, the nominally 50,000-strong Libyan army (mostly conscripts) has long been distrusted and kept on short rations. Meanwhile, the colonel and his sons have built a paramilitary force of some 20,000 well-armed and well-drilled tribesmen loyal to their clan and backed by richly paid mercenaries from Chad and Niger.

Tribal militiamen, ferried by air from the Sahara, were deployed on the streets of Tripoli on February 21st and bloodily put down resistance there. A few days later, air transport was crucial again to Colonel Qaddafi's plan to recapture coastal towns close to Tripoli from rebel hands. Both Zawiya and Misurata still appear to be controlled by the opposition, after assaults by heavily armed forces loyal to the regime were repelled on February 28th. But Mr Qaddafi's forces have surrounded the towns and cut off the road links to Tripoli.

Any attempt by the rebels to move their own forces along the coast road to Tripoli from Benghazi, which is 1,000km (621 miles) long, will be vulnerable to air attack. But at present, with nothing approaching a unified command, the rebels appear divided about whether they want a no-fly zone. Some say that western help would tarnish their revolutionary credentials, whereas others argue that without help from Western air power they would be easy targets.

Without protection, the anti-Qaddafi revolution could yet stumble and fail. However, although the West has experience in policing no-fly zones, they are neither easy to impose nor guaranteed to prevent mass killings. Although Saddam Hussein was deterred by the no-fly zone in the north from taking terrible retribution on the Kurds after the first Gulf war of 1990-91, a similar attempt to suppress the Iraqi air force in the south was much less successful. The no-fly zone over Bosnia did not stop the massacre at Srebrenica in 1995.

A no-fly zone over Libya would probably have to be through a "coalition of the willing" rather than a UN Security Council resolution-which would probably be opposed by both Russia and China. Planes flying from an American carrier, probably the *USS Enterprise*, could establish a zone, but land bases, such as the well-placed American naval air bases in Sicily and Crete, would be needed to sustain a long campaign. And although a no-fly enforcement is fairly straightforward once everything is in place, it takes planning and resources: a fleet of around 100 fighter jets, aerial refuelling, airborne warning and control, robust data links between coalition aircraft, and rescue arrangements for any pilots who are shot down.

Coalition aircraft would first have to nullify Libyan air defences, which include nearly 100 MiG-25s and 15 Mirage F-1s equipped with Soviet-era air-to-air missiles and a huge arsenal of Russian surface-to-air missiles (SAMs). Some military experts, including Lieutenant-General David Deptula, a former fighter pilot who until recently oversaw air force intelligence at the Pentagon, think Libya has acquired more up-to-date SAMs in the past few years, and that these could threaten allied aircraft.

Before going ahead with a no-fly zone, the allies (America and Britain, perhaps joined by France and Italy) would have to ask themselves two questions. How long they are prepared to stick at it if Colonel Qaddafi hangs on? And how much "mission creep" will they allow? The prospect of an open-ended military commitment without UN sanction is, to put it mildly, concentrating minds.

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Revolution in Egypt and Tunisia

It's not over yet

The countries that started the wave of Arab change both have a long way to go

Sebsi, the stripling

TUNISIA is small and tidy, with a large, well-educated middle class amid its 10m-plus people and a long tradition of quiet politics. Egypt is big and messy, with a lot more people living in its capital, Cairo, alone than in the whole of Tunisia. Its few rich and its throngs of poor live in starkly different worlds, and endured a century of wars and shifting ideologies before the enforced 30-year slumber of Hosni Mubarak's rule. Yet the revolutions in each country, barely a month apart, followed notably similar patterns. The wobbly aftermaths of those convulsions also look much the same, as Tunisians and Egyptians grope their way into a more complex new world.

Tunis and Cairo remain anxious cities. The thrill of empowerment from the toppling of hated dictators has largely passed. So has the relief that came from the abrupt end to weeks of sporadic revolutionary violence and from diminishing fears of a deeper descent into lawlessness. For the passionate core of revolutionaries in both capitals, which includes Islamists, secular liberals, trade unionists and many in-between, what persists is a determination to ensure lasting change, amid worries over the lingering hold of the *ancien regime*.

But many among the working poor and middle class are warier of economic pain than they are thirsty for political gain. Petty crime is rising in both cities in the continuing absence of effective police, and businesses are slashing payrolls in response to pinched demand. Owners want order and predictability, and increasingly resent the disruption of strikes and protests.

Yet the protests in both countries continue, and continue to produce results. In Tunisia a sit-in by tens of thousands of protesters led to the resignation of the prime minister, Mohamed Ghannouchi, a holdover from the fallen government of the ousted president, Zine el-Abidine Ben Ali, on February 27th. Despite the dissolution of the former ruling party, in which Mr Ghannouchi had been a bigwig for many years, his resistance to a fuller purge and attempts to forge long-term policies were seen as hindering a complete break with the past. Five other ministers soon followed suit, including two from opposition parties, who voiced doubts over the government's commitment to reform.

The feeble-looking caretaker government, which is to pave the way for elections in July, is now run by Beji Caid Sebsi, an 84-year-old former foreign minister. Acceding to crowd pressure, he has quickly reversed a two-decade ban on Tunisia's main Islamist party, and freed the last of its prisoners. The assets of some 110 members of Mr Ben Ali's extended family have been frozen or transferred to state control. But campaigners for democracy would also like the still-sitting pre-revolution parliament dissolved, and a fresh assembly created to draw up a new constitution.

Those last steps have already been taken in Egypt, where the army, much stronger than in Tunisia, has assumed overall control. The 18 generals of the high command have also told a committee to revise the constitution to prepare for an open presidential election in August. In a series of meetings with opposition leaders, they have insisted that they sincerely want an early return to civilian rule. As if to presage that event, the prime minister, Ahmed Shafiq, an air force general, stepped aside on March 3rd. Dozens of former officials are to be prosecuted for corruption, in a campaign recently extended to Mr Mubarak and his family.

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Still, much of Egypt's disparate opposition remains wary of the generals and nervous lest too rapid a transition empowers remnants of the ousted ruling party and the Muslim Brotherhood, the only broad-based political forces. At the same time, Egypt's economy has run into trouble. Unlike Tunisia, which relies on summer tourism, Egypt's tourist industry is year-round and has already been battered, along with many associated services. Egypt also has a high level of government debt, and faces a sharp fall in remittances from an estimated 1m Egyptians working in Libya, many of whom are straggling home to swell the ranks of the unemployed. They are returning to a very different country, excited by revolution but still mired in troubles.

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Saudi Arabia

The royal house is rattled too

Can the richest of all the Arab royal families stem the tide of reform?

IN NORMAL times a government sitting on $440 billion in foreign reserves would have few cares. Even in the present season of turmoil in the Middle East, Saudi Arabia is lucky. With the price of oil up by $10 a barrel since January, and the Saudis squirting out spare stuff to make up for the slump in Libya's output, the world's largest oil exporter is raking in a windfall. Feeling generous following his return in February after three months' convalescence abroad, King Abdullah announced an extra $36 billion to be spent on welfare and public services.

Yet the Saudi stockmarket suggests that something is amiss. In the week to March 2nd its main index plunged by 14%. All but a couple of Saudi Arabia's 11 close neighbours facing a degree of unrest, and those two, Qatar and the United Arab Emirates, have tiny native populations, proportionally even greater hoards of cash, and traditions of openness and tolerance that contrast starkly with Saudi Arabia.

The kingdom in the middle has largely avoided regional ills, bar Islamist radicalism. Despite a rigid, state-imposed conservatism that shuns any semblance of democracy, the aged leading princes, and the unsavoury antics of lesser princes lording it over them, Saudi Arabia's 25m inhabitants have rarely protested loudly. The few who have, in polite petitions or the odd display of anger, particularly by members of the oppressed Shia minority who number around 10%, have usually been coerced or co-opted by royal largesse into silence.

By allowing for a margin of free speech, personally responding to citizens' appeals, upholding religious orthodoxy and keeping a grip on well-equipped and loyal security services, the ruling family has so far parried demands for real reform.

They may again succeed. It is hard to imagine a crowd of 1m pampered Saudis gathering in any of the kingdom's sprawling cities to shout for their rights, as Egyptians have. It is even harder to imagine a Saudi king hunkered like Libya's Muammar Qaddafi, ranting as his realm unravels.

Yet the Arab awakening is prompting the kingdom's own malcontents to raise their voices. At least three petitions calling for radical political reform have recently circulated online. The most serious, signed by more than 1,500 prominent Saudis, including both liberals and Islamists, calls for 12 measures to turn the kingdom into constitutional monarchy, with powers balanced between an independent judiciary, an accountable executive and an elected parliament. A separate Facebook

initiative has even called for Saudis to join a "day of rage" on March 11th, in emulation of the protest that sparked Egypt's revolution.

Few expect a big turnout and few think the 87-year-old king will suddenly heed demands for change. Aside from blocking the petitioners' websites, Saudi authorities have responded by arresting a Shia cleric who backed the call for a constitutional monarchy in his Friday sermon. The king's huge package of extra aid, which included household-debt relief, bigger housing loans and a 15% raise for state workers, was a standard response to public pressure.

Yet this time those pressures may not so easily subside. Inspiring examples of people's empowerment in neighbouring countries are not the only reason. The increasing disconnect between Saudi subjects and their rulers, growing stresses in Saudi society, and troubles inside the ruling family all point to turbulence ahead.

Whereas 70% of Saudis are under the age of 30, and their median age is 19, the Saudi cabinet ministers average 65. Some senior princes have held their jobs as ministers or provincial governors for decades; one has governed the Northern Borders Province since 1956. Whereas 40% of Saudi youths have no jobs and nearly half of those in work take home less than 3,000 riyals ($830) a month, every prince (of whom there are probably 7,000-8,000) gets a monthly stipend ranging from a few thousand dollars up to $250,000, according to an estimate in a WikiLeaks cable.

In forums where Saudis are able to express discontent, anger is rising. Out of 1,600 asked in a recent web poll to rate the credibility of statements by Saudi officials, 90% ticked "untrustworthy". Asked what would come of a government inquiry into flooding that struck the kingdom's second city, Jeddah, in January, killing ten, 85% said "nothing". Scepticism was understandable, since an even deadlier wave of rainwater mixed with sewage engulfed the city last winter, prompting another investigation and promised cures. In a silent comment, Saudis exchanged a cartoon depicting the royal seal's crossed swords over a palm tree as crossed mops over a bucket.

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King Abdullah himself is fairly popular, but the brothers in line to succeed him, Crown Prince Sultan, at least 83 and said to be a victim of Alzheimer's disease, and the long-serving interior minister, Prince Nayef, now 77 and said to be suffering from diabetes and osteoporosis, are not.

Even the king is no longer immune to criticism. The last of the petitioners' 12 demands includes a pointed rebuke to him for lavishing the past few years' record oil revenues on giant new cities and a new university costing $12 billion. Such funds, say the petitioners, have been squandered in "expensive, cost-ineffective projects".

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Yemen's turbulence

Time running out?

The president nears the brink

"I'M going to reveal a secret," announced Yemen's increasingly embattled president, Ali Abdullah Saleh, to an audience at the university of his capital, Sana'a, on March 1st. "There is an operations room in Tel Aviv that aims to destabilise the Arab world." He added, unwisely for a ruler who relies heavily on American aid, to the tune of $300m last year: "It is all controlled by the White House." Playing on fears of foreign involvement is an old trick. Mr Saleh needs new ones quickly if he is to fend off the rising tide of opposition at home.

Tensions have been steadily rising on the streets of Sana'a as demonstrations against the president continue to grow. Competing with the protesters, cars with loudspeakers blast out pro-government propaganda as they patrol the streets; a helicopter circles low over the stone tower-houses of the old city; on a bridge above a main road, a woman in a *niqab* carries aloft a placard bearing a picture of the president's stern mustachioed face.

Western embassies and aid agencies are worried. E-mails and text messages have gone out to British citizens warning them to stay indoors and to stock up on food and water. Australian nationals are being advised to leave immediately. UN staff have been told to stay at home. In Aden, the port city in the restive south where most of the 27 deaths recorded during the protests have occurred, few Westerners venture out after dark. In the evenings young Yemenis take to the streets, burning tyres and throwing rocks.

Mr Saleh looks ever more isolated as tribal leaders and opposition figures line up behind the protesters. Ten members of parliament from the ruling party have resigned. Some key tribal leaders have announced their support for the anti-Saleh movement. On February 28th the opposition coalition rejected the president's offer of a unity government and chose to join the protests instead. On March 2nd rumours circulated that he had dandled the prospect of his stepping down by the year's end. Plainly the killings-and the photos of the dead festooning the protesters' camp-have undermined him badly.

But despite the protesters' improving organisation and passionate promises that they will stay "until he leaves", they still lack the weight of numbers that ejected the leaders of Tunisia and Egypt. And opposition parties and Islamists seem to be taking over their previously non-party and mainly secular movement. A radical cleric and leading opposition figure, Abdul Majid al-Zindani, joined the March 1st protests. Once an ally of the president, he has broken ranks to call for an Islamic caliphate.

A prominent Yemeni journalist, Nasser Arrabyee, says the opposition leaders are saying one thing in the street and another behind closed doors. Some may still be ready to cut deals with Mr Saleh. But they sorely lack a leader.

Power in Yemen still lies largely with clerics and tribal leaders. But they too may be edging away from Mr Saleh. The powerful al-Ahmar clan, including the wealthy and well-connected sons of Yemen's recently deceased kingmaker, Sheikh Abdullah al-Ahmar, has been backing the anti-government demonstrators. On February 26th one of them, Hussein, announced his resignation from the ruling party before a crowd of 10,000 cheering tribesmen.

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Even if Mr Saleh stepped down peacefully, Yemen's future would remain bleak. "After [Mr Saleh] goes we will nominate someone who will establish justice and give rights back to the Yemeni people," says an optimistic former bank manager who was one of the protesters on March 1st. But such a man will be hard to find.

A minister talks with despairing candour of Yemen's moribund civil service, which often seems akin to a large-scale unemployment-benefits scheme. Yemen's tatty economy barely profits from the rising price of oil, as expensive subsidies for diesel fuel offset much of the gain.

Mr Saleh, a past master at balancing the tribes and dispensing patronage, seems determined not to be hustled out of office after nearly 33 years. But it seems increasingly likely he will have to go soon.

Protests in Iraq

Even a democracy is not immune

Corruption and poor services are making people ever angrier

Yelling for power-and other services

ALTHOUGH Iraq is a rarity in the Middle East for having a freely elected parliament and government, it has not been immune to the wave of popular wrath sweeping across the region. Protests in different parts of the country, often violent, are gaining momentum. And the government is reacting badly.

Rallies got off to a bloody start on February 16th when three demonstrators were killed in the southern city of Kut. A week later, inspired by earlier "days of rage" in Egypt, Tunisia and Yemen, bigger crowds amassed in more of Iraq's cities, with at least a dozen being killed in clashes with police. In Baghdad several thousand gathered in their own Tahrir Square, and are likely to do so again on March 4th, Friday being the traditional day for mass protests.

The anger is being aroused mainly by the government's continuing failure to provide decent basic services, such as a regular supply of electricity, and by the corruption and sloth of their elected representatives. Heavy-handed tactics to squash the protests are making Iraqis even angrier.

The prime minister, Nuri al-Maliki, has tried various methods to keep them at bay. "Saddamist elements", he said, would infiltrate the crowds, and al-Qaeda would then launch attacks on them. Shia clerics friendly to the government told their followers to stay away. Security officials issued warnings that there would be bombs. For days before the rallies, soldiers patrolled the towns. On the day itself, a curfew was imposed and all vehicles, even bicycles, were banned from the streets.

In the square many journalists, especially those with cameras, were arrested and beaten up. A television station that got its cameramen to film a crowd trying to get into the Green Zone, the fortified area where many officials work and reside, was ransacked by security forces.

Elsewhere efforts to squash demonstrations were less successful. In Fallujah, a Sunni town to the west of Baghdad, the mayor's office was burned down and the council resigned, as did the provincial governor of the biggest southern city, Basra. In Baghdad, in the days after the protests, both Mr Maliki and parliament's speaker, Osama al-Nujaifi, dropped their earlier claims that Saddam's Baathists were responsible for the protests and endorsed calls for early provincial elections-in recognition, they said, of the people's wishes.

Protests have also erupted in the Kurdish region, the least violent bit of Iraq, where people have become increasingly fed up with the corruption of the two dominant parties and their shameless exercise of patronage in dishing out jobs and contracts. At least four people have been killed since the protests in Iraqi Kurdistan began.

Across the board, Iraq's leaders are right to be rattled. As violence has diminished in the past few years, calls for better services have grown more urgent. Iraqis want democracy in principle but are frustrated by its results-and by the seeming inertia of their representatives, who took nine months to form a government after last year's election, pick up fat salaries and have got hardly any of their promised infrastructure projects off the ground.

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Moreover, Mr Maliki is becoming still more authoritarian. In January a supreme federal court ruling allowed several independent institutions, including the central bank and various committees that are meant to oversee elections, fight graft and uphold human rights, to fall under the control of the executive. Mr Maliki has been trying to place his allies in several of these outfits. Qassim Aboudi, who heads the electoral committee, said he feared that Mr Maliki would interfere even more in the next election than he did in the past one. Worst of all, reports have been circulating that security forces loyal to Mr Maliki are again running secret prisons where detainees are being tortured.

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Oman

The sultanate suddenly stirs

A benevolent autocrat should survive in the face of a rare bout of dissent

IT WAS considered a corner of the Arab world least likely to catch the backwash of anger swilling around the region. But even Oman has been splashed. An outburst of anger expressed mainly by jobless or ill-paid youths in the port of Sohar left at least one person dead; some reports put the toll as high as six. Few Omanis think Sultan Qaboos, who recently celebrated 40 years on the throne, is wobbling. Still, even he will have to heed the more disgruntled of his subjects. And calls for giving more power to his *majlis al-shura*, a partially elected advisory council, may well grow louder.

The protests took place on February 26th and 27th in the port of Sohar, Oman's second city. A police station was torched, a supermarket later trashed. But a few days afterwards thousands of Omanis took to the streets of the capital, Muscat, to show their loyalty to the sultan, albeit with his state apparatus co-ordinating the event. Residents say there was a swell of genuine affection for him, particularly among older Omanis.

Compared with his reactionary father, Said bin Taimur, who was displaced by the present sultan in a British-backed coup in 1970, he has opened up the country and brought previously unimaginable prosperity to his 3m people. He has used the proceeds from 860,000 barrels of oil a day to build roads, schools and hospitals. At last count, the IMF reckoned that the country's GDP per head was $18,000, about seven times higher than Egypt's.

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The protesters' main demand was for more jobs-and welfare for those without them. Sultan Qaboos has hastily declared that this will be done, raising the minimum wage by 40%, to 200 riyals ($520) a month.

The rioters' political demands were more modest than those of their cousins elsewhere in the Arab world. Few called for the monarchy to be replaced or for full-blown democracy. But they want the sultan's advisory council to have more power. They also want the sultan to sack some unpopular ministers, tackle corruption, give the press more freedom, and curb the influence of rich families close to government.

They seem to have gained ground already on all fronts. Newspapers such as the *Muscat Daily* have begun to cover the protests in a way that would have been unthinkable even a week ago.

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France's foreign-policy woes

Nicolas Sarkozy's diplomatic troubles

France dumps its foreign minister, Germany its defence minister-and all of Europe frets over its place in the world

BY MOST measures, the Arab uprisings ought to have given France a chance to show off its diplomatic prowess. The former colonial power in Tunisia (and Morocco and Algeria), France has long claimed a special understanding of the Arab world, the ancestral home of millions of its citizens. Nicolas Sarkozy talked early in his presidency of the need for Europe to reach out to countries on the Mediterranean's southern rim. And Mr Sarkozy is presiding over the G20 and G8 clubs, lending him a platform for leadership. Yet France has veered from complicity to confusion.

It took until this week for Mr Sarkozy to begin repairing the damage by dismissing Michele Alliot-Marie, his foreign minister, and reorganising his diplomatic team. Ms Alliot-Marie had become a liability. In January she offered the know-how of French security forces in crowd control to the Tunisian regime only days before the president fled. And it then emerged that, when holidaying in Tunisia over the new year, she had flown twice on a private jet belonging to a local tycoon who had links to the regime-and to her parents via a property deal. Mr Sarkozy tried to shrug all this off, having reshuffled his team only recently. But it became impossible for the foreign minister to do her job. Last week the president sent Christine Lagarde, the finance minister, to lead a delegation to Tunisia, with Ms Alliot-Marie kept at a safe distance in Brazil. Such absurdities were not sustainable for very long.

On February 27th Mr Sarkozy announced both "a new era" and a new foreign minister, Alain Juppe. This marks quite a comeback for the Gaullist former prime minister, who has already led the foreign ministry once in the early 1990s. In 2004 Mr Juppe was banned from political life for a year and given a 14-month suspended prison sentence, for political corruption linked to a fake-jobs scandal at the Paris town hall when Jacques Chirac was mayor. Although he was an unloved prime minister in 1995-97, he earned sympathy for carrying the can for Mr Chirac, who himself faces trial in a linked corruption case next week. France likes to recycle its politicians and, since he returned from a year in self-imposed exile in Canada, Mr Juppe has slowly rebuilt his career. Last year Mr Sarkozy brought him back as defence minister. This week, in a statement that did not refer even once to Ms Alliot-Marie, Mr Sarkozy described him pointedly as "a man of experience".

Up to a point, foreign policy will remain in the president's hands, as it always has under France's fifth republic. But Mr Juppe has won himself a bit more freedom than his predecessors had. In this week's mini-reshuffle, and reportedly as a condition set by Mr Juppe, Mr Sarkozy made Claude Gueant, chief of staff at the Elysee, interior minister in place of Brice Hortefeux, who becomes a presidential adviser. This rids Mr Juppe of a source of rivalrous parallel diplomacy, since Mr Gueant ran a network of personal contacts in Africa and the Arab world from the Elysee.

The diplomats now hope to turn the page on what one admits "has not been our finest hour". France was tardy in Tunisia and wavered over Egypt. One poll finds that 81% of respondents think France's international role has weakened. An anonymous group of diplomats wrote in *Le Monde* a week ago that "France's voice in the world has disappeared" and its "foreign policy is dictated by improvisation".

Already, the response to events in Libya has been nimbler. In 2007 Paris was shut down to welcome Colonel Muammar Qaddafi and his entourage; he was allowed to pitch his tent in a garden next to the Elysee. By contrast Mr Sarkozy has called the latest repression in Libya "revolting", and called for sanctions. Mr Juppe was one of the first ministers in Europe to urge Colonel Qaddafi to quit. The prime minister, Francois Fillon, has sent two aid aircraft, carrying medical staff and supplies, to the rebel-held town of Benghazi.

France plainly does not want to find itself again so close to being on the wrong side of history. It helps that, as the uprisings have spread, French interests happen to align with their values. Mr Sarkozy has vowed henceforth to support "the values which are dearest to us, those of human rights and democracy". Whether this means a lasting policy change is another matter. France has long been a big seller of weapons and fighter jets in the region, including (until now) to Libya. Other strongmen that Mr Sarkozy vowed to evict in democracy's name, such as Laurent Gbagbo in Cote d'Ivoire, have been forgotten.

A broader worry lurks in some minds. If France no longer seems to command the world's attention as it did a few years ago, could this be because it lost its singularity when Mr Sarkozy returned the country fully to NATO in 2009, reversing Charles de Gaulle's 1966 withdrawal from its military structure? The group of anonymous diplomats argued that "joined to the United States, as manifested by our return to NATO, we no longer interest anybody much because we have lost our visibility". Two years ago, a certain Mr Juppe thought likewise, posing on his blog the question: "What advantage will we gain from losing this specificity?"

The argument is hard to disprove, or to disentangle from other factors, most notably a broad loss of influence for Europe and Mr Sarkozy's mercurial diplomatic style. By putting an end to its instinctive anti-Americanism, France has restored much-needed confidence in its transatlantic ties. This in turn helped to produce last year's Anglo-French defence agreement. It would be absurd, as yet another batch of anonymous French diplomats has argued in a surreal debate conducted in newsprint, to "return to a mythical past where France could exist only by opposing America". Since 2009 two French generals have secured strategic NATO command posts. This seems to have been enough to satisfy Mr Juppe, at least. Referring to France's reintegration into NATO, he told *Le Figaro* recently that "in the end, the benefits outweigh the disadvantages." Just days later, he was appointed foreign minister.

See also: Guttbye Guttenberg

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Germany's defence minister goes

Guttbye Guttenberg

The Teflon minister was ready to fight, but reached his limit

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HIS boss backed him. The voters stood by him; it was the intellectuals who brought him down. On March 1st Karl-Theodor zu Guttenberg, Germany's most dashing politician, quit as defence minister after the revelation that his 2006 doctoral thesis had borrowed heavily from others. His exit is a blow to Chancellor Angela Merkel's Christian Democratic

Union (CDU) and its Bavarian partner, Mr zu Guttenberg's Christian Social Union (CSU). It is also a setback to his plans to reform the army. The extent of the damage may not be clear for a while.

Mrs Merkel had tried to defend Mr zu Guttenberg, saying that she had hired a minister, "not a research assistant". But that only made the academics angrier. Graduate students denounced her for making it "sound as if obtaining a doctoral title by fraud is just a trivial offence". Their open letter was signed by more than 60,000. Mr zu Guttenberg was battered via Twitter and Facebook like some north African dictator (even if some 500,000 Facebook users "want Guttenberg back"). Around 400 protesters brandished their shoes Arab-style in Berlin.

In the end, Mrs Merkel's distinction between exemplary minister and corner-cutting doctoral candidate collapsed. CDU and CSU leaders began to ask if they could stand as upholders of personal responsibility and intellectual-property rights with Mr zu Guttenberg in his post. Mrs Merkel's advocacy of Germany as an "education republic" began to ring hollow. Annette Schavan, the education minister, said she was "ashamed".

Mr zu Guttenberg's successor as defence minister is Thomas de Maiziere, the CDU interior minister. He has none of Mr zu Guttenberg's charisma, but is close to the chancellor and, more important, has the managerial skill to see through a complex military reform. The new interior minister, a more senior job, is Hans-Peter Friedrich, head of the CSU faction in the Bundestag.

Filling the hole in Germany's political life will be harder. Voters seem increasingly indifferent to politics. Party membership and election turnout are both declining. Increasingly, citizens protest or call referendums instead. Mr zu Guttenberg offered a fresh face. Well-born, well-spoken and well-groomed, he seemed blunt where others prevaricated, principled where they plotted. Alone among German leaders he made the voters' hearts quicken. Mrs Merkel is respected but hardly loved. The minister's fall would be "a big disappointment for people," admitted a leading conservative.

The political consequences will become clearer in three state elections later this month. Normally, local issues matter more than national ones in such contests. Mr zu Guttenberg's resignation could help the CDU's rivals, if only because he will not campaign. But it might just mobilise party supporters. At a campaign event in Baden-Wurttemberg, the biggest of the three states, Mrs Merkel accused Mr zu Guttenberg's foes of "hypocrisy and mendacity". That was more tactical than principled, but it might help the CDU to hold on to a state it has governed for more than half a century.

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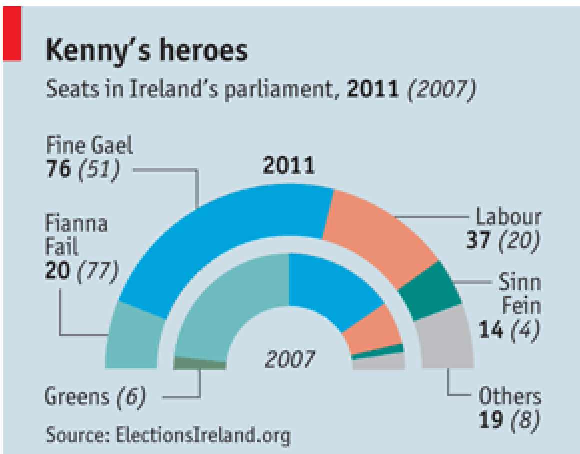
Ireland's new government

Enda the party

A crushing of Fianna Fail heralds a new prime minister and perhaps big reform



THE pent-up anger of the Irish electorate, which has been mounting steadily since 2008, has found loud expression. As Ireland plunged into the economic mire and was forced to accept a humiliating euro85 billion ($115 billion) bail-out from the European Union and the IMF last November, voters waited to exact their revenge. On February 25th they chose to

punish the Fianna Fail-led government that presided over a boom and then a bust, and to end its dominance as the natural party of government, at least for five years, and perhaps for much longer.

This marks the most momentous watershed in Irish politics since 1932, when Eamon de Valera first led Fianna Fail, the nationalist party he had founded, into government. There it has remained for three out of every four years since. For eight decades the party has shaped much of modern Ireland; its utter rejection by voters now is a humiliation. Fianna Fail lost three-quarters of its seats (dropping from 78 to 20) to become the third party in parliament. Many ministers, including Brian Cowen, the outgoing prime minister, wisely did not seek re-election. Most of those who did stand were defeated.

Fianna Fail's story has echoes of the experience of the Catholic church in Ireland, which suffered a huge loss of moral authority and public confidence after covering up sex-abuse scandals involving some clergy. Both Fianna Fail and the Catholic church, twin pillars of an older dominant order in Ireland, have been weakened and damaged by events that were at least partly within their control.

For Fine Gael, a centre-right party, the election marked its greatest success. It was a triumph for its leader, Enda Kenny, for many years the most underestimated man in Irish politics, who will now become prime minister. Only eight months ago this former teacher, who is Ireland's longest-serving parliamentarian, defeated a leadership challenge by front-bench colleagues. Nine years ago Mr Kenny inherited a demoralised party reduced to just 31 seats. He has rebuilt it from the grassroots to today's 76. Fine Gael is twice as big as its likely coalition partner in government, the centre-left Labour Party, which almost doubled its representation. Between them, the two parties hold two-thirds of the seats in the new parliament, making their probable coalition into a national government, with the largest parliamentary majority in Irish history.

Much will now depend on the parties' talks about a joint programme. If these are to conclude by March 6th, as planned, the two need to narrow their differences on tax, public spending and the speed of budget-deficit reduction, among other issues. But the new prime minister's most immediate test will come at an EU summit at the end of the month. There he will try to win concessions on the terms of Ireland's bail-out, especially a less penal interest rate. Mr Kenny's chances of success are small-and he will also have to fend off pressure from his new colleagues to raise Ireland's low (12.5%) corporate-tax rate.

Political reform will be a second big policy challenge. Both parties favour the abolition of the Senate, Ireland's upper house. Fine Gael also wants to cut the size of parliament by 20 seats. And both promise to clean up politics, end cronyism (curbing the influence of property developers), improve corporate-governance standards and introduce an independent fiscal council to oversee the budgetary process. It may sound dull, but if the parties manage all of this, they will change Irish politics permanently and for the better.

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Italy and immigration

Fear of foreigners

The Italian government worries about a huge influx from north Africa

All washed up and ready to go

NOWHERE has the Libyan uprising caused greater anguish than inside Silvio Berlusconi's Italian government. Distress at the death of so many protesters? Sympathy for the prime minister's friend and erstwhile ally, Muammar Qaddafi? Neither, really. What has prompted reactions ranging from alarm to hysteria is the prospect of a sharp increase in immigration from the Maghreb. The foreign minister, Franco Frattini, feared "an exodus of Biblical proportions". It would bring Italy "to its knees", said the interior minister, Roberto Maroni. Mr Frattini talked of 200,000-300,000 arrivals, creating a future that was "impossible to imagine".

The government has good reason to worry. The achievement of which it is perhaps proudest is a sharp cut in the flow of illegal migrants across the Mediterranean (from 36,951 in 2008 to only 4,406 in 2010). It managed this by striking deals with Libya in 2008 and Tunisia in 2009 under which both countries were paid to clamp down on human trafficking. The danger is that these agreements will be rendered null by the chaos. On February 26th Italy declared that its friendship treaty with Libya was "de facto no longer in operation" (though that was probably to free it from an obligation not to use force against its former colony: as later became clear, Italy supports a no-fly zone).

The earliest tear in the diplomatic membrane shielding Italy came after the uprising in Tunisia. More than 5,000 people fled to the little Italian island of Lampedusa, which is closer to north Africa than to Sicily. The Italians elicited an outraged response from Tunis when they suggested intervening militarily to block the boats. But the Tunisians seem to have tightened their grip and this, assisted by bad weather, stopped the landfalls until March 1st, when the first of 413 people, mostly Tunisians, arrived on Lampedusa and a nearly island. Unsurprisingly Mr Maroni failed to convince his European colleagues in Brussels on February 24th that Italy was facing a "catastrophic humanitarian crisis".

His real worry is Libya. The total estimated foreign population there is put as high as 1.5m. There have been reports of sub-Saharan Africans being attacked and even killed by anti-Qaddafi protesters who mistook them for mercenaries. Yet it would be absurd to claim that all foreigners in Libya will go to Italy; most would prefer to return home. There is little evidence of their fleeing northward so far. The UN High Commissioner for Refugees says that, of 55,000 people who crossed into Egypt between February 10th and 28th, all but 6,900 were Egyptians or Libyans. Most others were Asian.

The Italian government's fear is that hundreds of thousands may yet take advantage of the disorder to embark for Europe. But the disruption may affect people smugglers as much as anyone. For the moment, the numbers seem bearable in a country of 60m. Germany's outgoing interior minister, Thomas de Maiziere, noted that Sweden, with a population of only 9m, took 30,000 asylum-seekers last year.

Where there is a real and immediate humanitarian emergency is on Tunisia's border with Libya. On March 1st, in an abrupt and welcome change of tack, the Italian government announced that it was putting some money into a humanitarian mission to the area. Mr Maroni said it would provide food and shelter for 10,000 people, "but also stop them from leaving".

Albanian altercations

A pair of Balkan neighbours falter on the road to Brussels

THE dream that Albania has of joining the European Union is in deep trouble. That is the bleak assessment of Miroslav Lajcak, the EU's point man in the Balkans. Mr Lajcak has been trying to broker an accord between Sali Berisha, the prime minister, and Edi Rama, the leader of the opposition. He declares that, unless the two strike a deal before local elections in early May, they will share responsibility for the mess, "no matter what they say".

There has been no normal politics in Albania since a general election in June 2009, when Mr Rama accused Mr Berisha of fraud. The opposition boycotted parliament and hunger strikers camped outside Mr Berisha's office. This was deemed unbecoming for a country that had just joined NATO and had applied to the EU, so outsiders applied pressure to both sides. Now they have stepped in again: Jim Steinberg, the American deputy secretary of state, visited Tirana on February 25th. But as Mr Lajcak's tone suggests, Albania's foreign friends are losing patience.

The latest trouble flared in January, when Dritan Prifti, a former economy minister, gave a video to a television station that seemed to show Ilir Meta, the deputy prime minister, discussing a large bribe. Mr Meta denounced the tape as a fake, but still resigned. A few days later an opposition rally turned into a tragedy. Observers say a hard core of protesters were looking for trouble. But nobody expected that the Republican Guard in the prime minister's office would open fire, killing four people in the crowd.

Mr Berisha promptly accused Mr Rama of trying to mount a coup, using guns disguised as umbrellas. When the public prosecutor indicted some members of the Republican Guard, Mr Berisha sought to block her plans to have them arrested. He called the prosecutor a "boulevard whore" who was in on the opposition plot.

Genc Pollo, a minister in Mr Berisha's government, insists that the rally was "a well-organised attempt to launch an assault on the main government building, where the prime minister and others were". Nonsense, scoffs Mr Rama. "They stole the elections to rob the country and now they are able to kill people in order to continue to rob the country."

Mr Berisha believes he has American support. That gives him the backbone to resist making a deal with Mr Rama. But Mr Lajcak says the two men need to agree on how to avoid the problems that led to charges of electoral fraud before the May local elections. Otherwise the charges will be repeated, the instability will continue-and Albania's hopes of joining the EU will in effect be shelved.

The situation is little better in Kosovo. It held a flawed election in December, but reruns and lengthy coalition talks meant no new government was formed until February 22nd. The prime minister is Hashim Thaci, whom a recent Council of Europe report accused of being a mafia boss connected to those responsible for a macabre trade in human organs from

captured Serbs in the late 1990s. Behgjet Pacolli, a controversial tycoon with close ties to Russia, Serbia's main backer, has been chosen as president, but the opposition is challenging this. None of this will help Kosovo towards the EU either.

Turkey's Islamists

Erbakan's legacy

What a prime minister's funeral says about democracy and Islam

HE WAS booted out by Turkey's generals in what became known as the postmodern coup in 1997. One even called him "a pimp". He was jailed and his party banned. Yet the top brass were among thousands of Turks at the funeral of Turkey's first Islamist prime minister, Necmettin Erbakan, on March 1st (poignantly, a day after the coup's 14th anniversary). The chief of the general staff hailed Mr Erbakan's "great services to our country as a valued man of science and politics".

Cast by his secular enemies as a dangerous religious reactionary, Mr Erbakan is now acknowledged as a moderating force on Turkey's Islamists. As the Arab world looks to Turkey as a possible model, Mr Erbakan's legacy has new significance. Turkey's prime minister, Recep Tayyip Erdogan, and president, Abdullah Gul, both cut their political teeth under him. He was fiercely anti-Western, decrying the European Union as a Zionist Christian club and railing against usury and the free market. Yet unlike some Islamists (but like Turkey's *Tarikat* Sufi Islamic fraternities), he disavowed all forms of violence. He sported a suit and tie (usually Versace). When the army pushed him out in 1997, Mr Erbakan did not call on his followers to take to the streets. He infused his message with generous helpings of nationalism. When asked about his humiliation by the generals recently, he responded: "They are the sons of this country too." He quarrelled with the state, though he was firmly wedded to it.

Yet it came as no surprise when Mr Gul and Mr Erdogan broke ranks to form the ruling Justice and Development (AK) party in 2001. In a big break with their mentor they embraced both the free market and the EU. Combined with the abject failure of secular rivals, this catapulted AK to single-party rule in 2002. Hasim Hasimi, a Kurdish former member of Mr Erbakan's party, notes that "splinter groups in Islamic movements outside Turkey went in the opposite direction: they became more radical." That is a concern in north Africa, too.

Speaking to journalists before a trip to Egypt this week, Turkey's foreign minister, Ahmet Davutoglu, drew comparisons between the Turkish and Egyptian armies. "They are truly national in character," he said. "The Egyptian army must be left intact in order that there be a peaceful transition to democracy." AK's critics might say the same should hold for Turkey, where a record tenth of all serving generals are in jail on charges of plotting to overthrow the government in the so-called Ergenekon case. No doubt coup-mongers are among them, yet there is widespread concern that some caught up in the trials are innocent people whose crime is to oppose AK. The main Turkish opposition leader, Kemal Kilicdaroglu, has called for the trials to be broadcast to help establish the truth.

Even as Turkey parades its model before the Arab world, Mr Erdogan should not forget that part of its attraction is its embrace of the EU. Yet this week he engaged in a new round of Europe-bashing (especially in Germany, where he accused his hosts of forcibly assimilating the Turkish minority), reinforcing speculation that AK is no longer really interested in joining the EU. Indeed with his talk of the EU being "a Christian club", Mr Erdogan sounds worryingly like Mr Erbakan 14 years ago. With an election approaching, Mr Erdogan may merely be trying to keep the nationalist opposition out of parliament by wooing its voters. At all events, Turkey's experience suggests that Islam and democracy remain a sustainable, if sometimes (as with Mr Erbakan) awkward, mix.

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Charlemagne

Living with bad neighbours

Europe tries to forget decades of embarrassing realpolitik in the Middle East

IMAGINE your awkward neighbours across the street. You befriended them, drew them into the neighbourhood-watch scheme and even made some nice trades. All of a sudden they are exposed as criminals, or maybe brutes with women enslaved in their basements. Would you feel guilt about your friendship? Remorse about having ignored the telltale signs? Or would you feign outrage, like Captain Renault's in "Casablanca": "I am shocked, shocked to find that gambling is going on in here!"

Such are the emotions that Europe's leaders feel as their friends across the Mediterranean are toppled by long-suffering subjects. True Europe has had little choice in its neighbours. Good relations were a necessity of life, particularly for countries with oil and gas, or those that guarded against terrorists and illegal migrants. Yet some European actions now seem craven indeed. Remember Gordon Brown's dissimulation about the release of Abdelbaset al-Megrahi, the Libyan jailed for life in Scotland for his role in the 1988 Lockerbie bombing? Or the sight of Silvio Berlusconi kissing the hand of Muammar Qaddafi? In the grab for a share of Libya's oil wealth, many others have been stained. Libyan petrodollars, moreover, have found their way into companies and institutions across Europe, from the Juventus football team to the London School of Economics.

Europe's leaders are now trying to disown their years of realpolitik, and instead make the cry of the Arab street their own. The contortions are more theatrical the closer they live to north Africa. Finland was the first to demand sanctions against Libya; Cyprus and Malta the last to agree. "The farther you are away from immigrants landing on your beaches, the more morally pure you can allow yourself to be," says one European diplomat.

Of the big European countries, Angela Merkel's Germany has been the firmest advocate of ostracising dictators. France suffered humiliation in Tunisia, but seized on the Libyan revolt to set matters straight. Nicolas Sarkozy sacked his hapless foreign minister, Michele Alliot-Marie, put France at the forefront of the push for sanctions and even sent aircraft laden with aid directly into liberated Benghazi (see article). France, he said, should not fear change in the Arab world; for the first time in history, democratic ideals "could triumph on all shores of the Mediterranean".

Italy's prime minister, Silvio Berlusconi, has perhaps struggled the most. He unwisely called Egypt's President Hosni Mubarak the "wisest of men", only to see him toppled. Early in the Libyan crisis he carelessly said he would "not dare disturb" his friend, Colonel Qaddafi, about the violence in his country. A week later he had to cast off the Libyan leader, saying it was time to "end the bloodbath and support the Libyan people".

David Cameron might have been an exception. Britain has long enjoyed close relations with the Arab world but Mr Cameron was in opposition when Tony Blair helped rehabilitate Colonel Qaddafi as a reward for giving up his weapons of mass destruction, forsaking terrorism and helping out in the fight against al-Qaeda. Mr Cameron was also the first foreign leader to go walkabout in Tahrir Square last month. But taking defence contractors with him to the Gulf invited mockery: a cover in *Private Eye* has him offering a two-for-one deal on tear gas and armoured cars and being invited to throw in his wife as well.

The conversions from realism to idealism are not wholly convincing. The UN Security Council, including veto-wielding champions of national sovereignty like China and Russia, moved more quickly to impose sanctions on Libya than did the EU. About $30 billion-worth of assets have been frozen in America, but the EU is unlikely to act on such a scale; its lawyers are despairingly trying to distinguish assets owned by the 26 individuals on the EU list from those belonging to the Libyan state. At a special summit next week, the EU has much to rethink.

Stefan Fule, the commissioner for "neighbourhood" policy, admits, "Europe was not vocal enough in defending human rights and local democratic forces in the region." Some Eurocrats bravely argue that the EU's soft power softened up Arab regimes: EU-driven telecoms reforms, they say, helped the Twitter and Facebook revolutions. A more persuasive conclusion is that promoting democracy with inducements and cash has failed. That does not stop southern EU members from seeking more aid for north Africa. The Germans want benefits tied more closely to reforms. A deal might involve "more for more": more aid and trade in exchange for more reform. But will southerners let Arab producers compete with their farmers and textile industries?

The danger of a big disruption of oil and gas supplies makes it more necessary to develop an EU-wide energy market and grids. And without autocrats to deter illegal migrants, countries will have to rethink their immigration policies. The Club Med countries want EU help to cope with a possible influx, but they have been shamefully slow to help Tunisia and Egypt, which are bearing the brunt of the refugee crisis.

Oil-for-freedom

For now, the most pressing question is how to speed up the departure of Colonel Qaddafi. Whether or not a no-fly zone is imposed over Libya, European leaders need to think about helping the Libyans to help themselves. So how to strengthen the liberated parts of Libya in the east and weaken the Qaddafi camp?

The French had one good idea when sending aid direct to Benghazi. Europeans could work to build up a temporary free government. Why not resume oil exports from the east, paying into an international escrow account to buy humanitarian supplies? This notion got a bad name with the embargo of Iraq. In Libya, though, it is not a form of sanction, but a means of economic assistance; not oil-for-food, but oil-for-freedom.

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Bradford and its communities

Hope over hate

Lessons in countering segregation from a northern city better known for riots than racial harmony

THE Ashwell Medical Centre off Carlisle Road in Bradford is a modest place, its clean lines and beige bricks offering no clue to the area's violent history. Ten years ago the Manningham Labour Club stood in its place-until it was firebombed on July 7th 2001 during what became known as the "Bradford riots".

Part of a wave of similar unrest that swept several northern industrial towns, the riots pitted young men of mainly Pakistani origin, provoked by a few members of the white National Front, against the police. Unlike previous urban disturbances, which were analysed in terms of poverty and exclusion, the northern troubles were elided with the atrocities in America in September 2001. They became part of an apparently seamless narrative about multiculturalism, segregation and terrorism.

So another event in Bradford, more recent and less remarked, is worth noting. On August 28th last year a rally by the right-wing English Defence League (EDL), which opposes what it calls Muslim extremism, and which saw Bradford as its big chance to ignite an inter-communal powder keg, passed off peacefully.

Police, councillors, churches, mosques and community groups worked together. Excitable youths were hauled out of harm's way and up Welsh mountains. Women of various hues wove peace ribbons across the streets. Churches held vigils. Muslims brought food to the police. Others stood with them against the EDL, forming "their own blue line", as Ian Greenwood, the council leader, puts it. Sikhs opened their *gurdwara* for the coppers to change their clothes in.

Bradfordians knew that 2001 had led to falls in reputation, university applications, tourism and perhaps investment. This was an attempt to close that chapter.

Back from the brink

To many, this turnaround verges on the hallucinatory. Even before 2001, Bradford had form. Home to Britain's fourth-largest and possibly most concentrated Muslim population, it was the scene of an early burning of Salman Rushdie's "The Satanic Verses" in 1989 and of a minor race riot in 1995. Its Muslims, many from rural Pakistan, tend to be conservative. Marriages with spouses from the subcontinent are still common. Pakistani families remain clustered in wards such as Manningham (though richer Muslims often move out, they are more than replaced by the plentiful babies that immigrant wives, especially, produce). Most of the preaching in the city's many mosques is in Urdu.

Since 2001, and especially since the London bombings in July 2005 by British Islamists (one born in Bradford), places like this have been uppermost in policymakers' minds as they try to untangle the connection, if any, between cultural separation and terrorism. Do communities in Bradford still lead "parallel lives", as a report into the 2001 disturbance in nearby Oldham put it-and if so, does it matter?

There are few signs that Bradford's whites and Muslims are bonding with any great gusto. This year's decennial census is likely to show that ethnic concentrations remain high. One well-off Muslim complains of white flight from even the posh suburb where he bought a house. Another says that school admission based on residence promotes segregation: his clever son could not attend a good mixed school but had to go to a mediocre, heavily Pakistani one instead. Ratna Lachman, who

works at Just West Yorkshire, an anti-racism NGO, relates that white boys simply pulled out of one project to bring youth together.

A lot of Bradfordians are uncomfortable even talking about segregation. "The assumption is that it is somehow Muslims' fault," says another local Muslim professional. "You don't find many white people from Ilkley [a prosperous suburb] coming in to hang out with Muslims." Saeeda Ahmed, a businesswoman who does foreign-aid work for the government, agrees. "What are we supposed to do to integrate? I am giving my life to this country, but I'm not going to change who I am."

Alyas Karmani, an imam originally from south London, suggests that while many Muslims in Bradford choose to live close to their mosques and familiar shops, poverty makes other choices difficult. In this, and in other ways, much of the strife is down to economics.

Bradford is a poorish place, though with pockets of wealth. It hasn't managed to replace its defunct mills-to whose night-shifts migrants from the subcontinent were welcomed from the 1950s-with service-sector firms, as its neighbour Leeds did. Unemployment in Bradford averaged 10.2% in the year to June 2010, versus 7.7% nationally. In heavily Asian wards such as Manningham, the rate is higher. But poverty is not confined to Muslims; there are desperately poor, mainly white areas too. This is the recipe for racial tensions.

Things are changing, however, and there are two keys: education and policing. In 2001 Bradford's school system was reckoned so dire by inspectors that the council was ordered to hand it over to a private company. Serco may not have done quite the job some hoped for (the council will resume control this summer), but exam results are improving. Nineteen schools in Bradford are now rated "outstanding" and the large majority "good".

Michael Latham, the head of Newby primary school, whose 520 children come from kaleidoscopic backgrounds, thinks its top mark is down to several factors. Newby insists on academic success; it instils a sense of ambition and pride in the school in its pupils, giving them another chunk of identity to set alongside family and faith; and it works with the wider community, not just parents. Most pupils go on to two nearby secondaries now also judged outstanding; many will get to university.

Policing is changing too. The police were widely blamed in 2001 for letting racial baiting escalate into full-blown violence. They failed to plan ahead, and had few personal connections in Bradford's ethnic-minority communities anyway. A new focus on neighbourhood policing, in which individual officers are given patches and made responsible for them, going door-to-door to identify concerns, has been championed by Chief Superintendent Alison Rose, appointed Bradford South divisional commander in 2008. The police worked with neighbourhood wardens and others to defuse the EDL demo. In 2001 many saw the police as protecting racists; in 2010 they were defending their city.

If Bradford has lessons for other towns that wrestle with segregation, it is that improving public services which better everyone's lot is likely to reduce tensions faster than trying to force cultural change. A new middle class is gradually emerging among Muslims, and with it a group of younger leaders who see Britain as their future. Education gives them choices, and neighbourhood policing a voice. The trick will be to build on those gains and give them a stake in the wider economic and political system.

What strikes an outsider is how everyone glories in the city. Bradford food is the best, says a middle-aged Muslim man. Bradford people "tell it like it is", says a young white woman. Neither would live anywhere else. If a rising economic tide lifts all boats, a common love of place might yet bind communities together.

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Financiers in Switzerland

Careful what you wish for

Bored and frustrated traders are homesick for grimy, high-tax London

HARRY LIME, a racketeer played by Orson Welles in "The Third Man", remarked that the only cultural legacy of centuries of stability in Switzerland was the cuckoo clock. The City types who have fled London for the quiet of Geneva or Zurich might see what he means.

Rising taxes, fears of tighter regulation and public hostility have persuaded some hedge funds and oil-trading firms to move to Switzerland. Other disgruntled financiers have threatened to follow. They might be bluffing: Geneva's finance minister recently said that the city was running out of office space-and some might in any case be deterred by the experience of the trailblazers. Many exiles find Switzerland oppressive and miss London's variety. Some are bored and plan to come home.

A lot of the complaints are about things that afflict the mobile elite elsewhere. Upping sticks is costly and onerous: family life is disrupted; newcomers find it hard to find nice homes; the friends left behind prove hard to replace. But problems that elsewhere might be solved by money are less tractable in Switzerland, where the merely well-off are outgunned by the super-rich.

Schools are one such battleground. Competition for places is fierce at the handful of schools where classes are taught in English. There are dark rumours of gazumping. "You need muscle to get kids into the international schools," says Alex, a financier who recently returned to London after a brief Swiss sojourn (names have been changed to prevent recriminations). "Otherwise it's a Swiss school, where your kids will find it hard to settle." A few opt to send their children to boarding schools in England.

Housing in Geneva is pricey even compared with the posher parts of London. Some choose not to buy because they might soon return home, but discover that flats for rent in the city centre are scarce. Expense is not the only problem. Leases often require newcomers to be vouched for by other tenants. Food and clothes are costly, too. Katy, a trader's wife, misses the discount retailers on British high streets.

Free-wheeling financiers who sought a lighter regulatory touch in Switzerland are infuriated that petty rules are rigidly enforced outside work. Kit, the head of a trading outfit, tells of a visit from a policeman one morning. He was threatened with a fine because his maid had put out the rubbish before 7am. Toilets cannot be flushed, or washing machines used, after 10pm without provoking strife. Taxis must be hailed from a rank. Red tape is rife.

Yet it is boredom that seems to hurt most. Traders find it hard to meet people from outside the world of finance. The snootiness and sameness of Switzerland is dispiriting, they say. Geneva is deserted in the evenings and at weekends. Shops and restaurants are closed on Sundays: "If you want a Sunday lunch, you have to drive to France," laments Simon, a hedge-fund manager. Friday flights to London are full. There is whispered talk of marriage-busting affairs with chalet girls.

And a lower tax bill does not always compensate for the expense and monotony of Swiss life. The tax benefits of Geneva are in any case overstated, says Kit. He reckons his firm pays 70% of its gross income in various taxes. Health insurance,

legal costs and accountancy charges are far higher than in London, he claims. Tax breaks are not always spread evenly. Some firms cut a bespoke deal for their top staff, says Simon.

The sharp rise in the Swiss franc has made it costlier for Swiss-based outfits to pay their wages (see chart). It has also increased the risks of leaving Britain for a spell abroad. A trader who sold his London property and relocated could lose much or all of his tax savings on his return if the pound recovers.

Not everyone is homesick. Geneva suits people who are over 35, have families, are established in their careers and like skiing, hiking or sailing, says Dylan, who has settled there. Such pleasures are within easy reach of Geneva, which is one reason it is empty at weekends. Younger migrants who prefer indoor pursuits, such as the arts or clubbing, seem to struggle.

Kit is moving his firm back to London. The best training for young traders is on the dealing floor of one of the big London-based banks, he says. London's size, it seems, is still a big advantage.

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Defence policy

The emperor's clothes

Events in north Africa have bolstered criticism of the government's defence cuts


Ark Royal might have come in useful

MOST British prime ministers end up trying to cut a dash on the world stage, even if at the outset they forswear such vanities. David Cameron has succumbed to the temptation more quickly than most. Responding to the events in Libya-after his government had attracted awful headlines for its initially cack-handed efforts to rescue British citizens-he grandly told MPs on February 28th that he had asked "the chief of the defence staff to work with our allies on plans for a military no-fly zone". To many, both at home and abroad, his words sounded hollow-because of the rapid erosion of Britain's military capability that he set in motion by approving the clumsy Strategic Defence and Security Review (SDSR) last year.

To be fair, Mr Cameron and his defence secretary, Liam Fox, were left a grisly military inheritance by the previous Labour government. It included a pound38 billion ($62 billion) black hole in the defence budget, caused by a "conspiracy of optimism" over ordering new kit among senior officers and civil servants, combined with a passivity bordering on negligence on the part of a succession of ministers. The pair can also fairly claim that, compared with the cuts of around 25% imposed on many other departments, the planned reduction in defence spending over the next four years of 7.5% actually represents a reverse of the trend under Labour, which largely excluded defence from the largesse showered on other public services.

But even taking the difficult circumstances of the SDSR into account, there is a feeling among many defence experts (and Conservative MPs) that the government failed to rise to what Michael Clarke of the Royal United Services Institute, a think-tank, describes as Britain's "strategic moment". The hastily conducted review, presided over by inexperienced ministers and the newly established National Security Council, was preoccupied with the needs of the current counter-insurgency campaign in Afghanistan, and insufficiently concerned about future-and possibly much bigger-threats.

Nor did the outcome suggest much understanding of American strategy, or how Britain should define its own role alongside its most important ally. Speaking to cadets at West Point on February 25th, Robert Gates, America's defence secretary, said that, in the future, "the most plausible, high-end scenarios for the US military are primarily naval and air engagements". Mr Gates added that any future defence secretary who advised the president to send a big American land army into Asia, Africa or the Middle East should "have his head examined". Yet, swayed by Afghanistan, the British government has spared the army the worst of the cuts while sacrificing its fixed-wing maritime air power.

Events in north Africa, and the possibility that instability might spread to the oil-producing Gulf, have already made the SDSR look myopic and out of date. It recently emerged that 15 retired commanders and military scholars wrote to the government in late January, urging it to reconsider the maritime component of the SDSR. They argued that the decision to scrap the entire fleet of Harrier jump jets and HMS *Ark Royal*, the navy's only active aircraft-carrier, represented a risky bet that Britain would not need any carrier strike capability for a decade, "in an uncertain, fast-moving and dangerous world". The debate over a Libyan no-fly zone makes that criticism look prescient: a carrier would be rather useful in enforcing one.

Dr Fox is adamant that the SDSR will not be revisited. After this week, Mr Cameron might not be quite so sure.

Labour's foreign policy

Beyond the water's edge

Douglas Alexander is shaping the opposition's take on the world

VOTERS tend to rank foreign affairs well down their list of concerns, so it is tempting for opposition parties to neglect the issue. The uprisings in the Arab world have illustrated the folly of doing so. In responding to the upheaval, David Cameron has been caught between commercial *realpolitik* and an intermittent zeal for toppling dictators-the confused result, say some, of a lack of serious thinking about the world when he was leader of the opposition.

The current Labour opposition's approach to international affairs will be defined largely by Douglas Alexander, who was appointed shadow foreign secretary by the party's leader, Ed Miliband, in January. His predecessor, Yvette Cooper, rarely seemed enthused by the portfolio. Mr Alexander, by contrast, is a former international development secretary and Foreign Office minister.

He distinguishes his evolving foreign policy from the government's in two main ways. First, he places less emphasis on advancing British commercial interests abroad. He regards promoting exports as important, to be sure, but sees it as less central to statecraft than does William Hague, the Conservative foreign secretary.

The other big difference is that Mr Alexander does not share the government's faith in bilateralism. Mr Hague accuses the previous Labour administration of neglecting the basic diplomatic work of building relationships with other countries. For him, "all foreign relations are bilateral." He has dispatched ministers on visits to places such as Angola and the Philippines. Mr Cameron's recent tour of the Middle East, conducted as the local revolts were developing, was partly aimed at reviving Britain's old alliances with Kuwait and other countries in the Gulf. Mr Alexander says all this has become a substitute for fully fledged engagement with multilateral bodies, such as the European Union, where he thinks the real power lies.

Labour is perhaps less divided by foreign policy than at any time since the second world war. The epic struggles between the party's pro-NATO, pro-European right and its pacifist, Eurosceptic left peaked in the 1980s. The rancour left behind by Tony Blair's military interventions, especially in Iraq, is slowly fading. Veterans lament the paucity of foreign-affairs discussions in the modern Labour Party-but that means Mr Alexander has the freedom to design a policy without provoking a schism.

Mr Alexander is emerging as one of the more interesting politicians in the shadow cabinet. He is perhaps the closest thing to a Blairite at the heart of Mr Miliband's operation. He used to work for Gordon Brown, whose Church of Scotland upbringing he shares, but always seemed more comfortable with the centrism of New Labour than more tribal Brownites did. His quiet, circumspect personality was not a natural fit in that laddish political clique, either. He brings a sharp mind and considerable experience to the foreign-affairs brief. But if Labour is to avoid drifting leftwards on fiscal policy, public-service reform and the other issues that really shift votes, it will need his input on domestic matters too.

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High-speed rail

The need for speed

Doubts about the business case are unlikely to derail high-speed trains

BRITAIN'S railways were built by the Victorians, and it shows. Large parts of the network remain un-electrified, for instance, more than 100 years after electrification was invented. But it will one day have a futuristic side, at least if the government gets its way. On February 28th it revealed more details about its plans for "High Speed Two" (HS2), a 225mph, pound32 billion super-quick railway line from London to Manchester and Leeds by way of Birmingham (see map). Assuming the project goes ahead, construction should begin in 2017, with the first trains running in 2026.

A smorgasbord of benefits will reputedly follow. Journey times between London and other cities will fall; a capacity shortfall on one of the main north-south rail routes will be avoided. The link will even speed the geographical "rebalancing" of the economy that the coalition has pledged to engineer, which will see activity less concentrated in the South East.

Not everyone is impressed. People whose houses face demolition complain about stingy compensation. Aesthetes worry that the line will deface some rather pretty parts of the country, particularly the Chiltern Hills, officially designated an "area of outstanding natural beauty".

Others question the business case. The plans for HS2 project a 133% increase in demand for long-distance rail travel between now and 2033-over twice as big a rise as most other analyses, even though there is considerable evidence that demand for transport no longer rises with economic growth. Better-off travellers, who would use the line most, would reap most of the benefits. And a large chunk of those purported benefits rest on the assumption that businessmen are unproductive while in transit, which seems questionable in an age of laptops and mobile broadband.

There are also doubts about high-speed rail's ability to boost regional economies: the government itself expects the scheme to generate almost as much benefit inside London as outside it. And the plan contradicts a report in 2007 by Sir Rod Eddington, a former boss of British Airways, which was meant to lay down the rules for transport spending for decades to come. Sir Rod advised using relatively small sums of money to alleviate individual transport bottlenecks, rather than blowing billions on *grands projets*. Although HS2 seems to have a positive cost-benefit ratio, there are other projects, chiefly in roadbuilding, that would provide a better return. Incremental upgrades to existing lines could keep the railways from clogging.

Admittedly, forecasting and cost-benefit analysis on big, long-term projects such as this amount to little more than complicated guesswork. But history counsels caution, too: Britain's only existing high-speed line, from London to the Channel Tunnel, has never come close to achieving its projected passenger numbers. The assumptions behind high-speed lines in other countries, such as Taiwan and France, have often turned out to be over-optimistic too.

Still, the economic arguments are sufficiently tangled that, in the end, they might prove irrelevant. Super-fast trains are politically appealing. They are gratifyingly high-tech; other rich countries have them; and they allow a government committed to drastic public-spending cuts to tell at least one happy tale of improvement and investment. High-speed rail is

one of the few issues on which all three big political parties agree. For all those reasons, and regardless of whether it is a good idea or not, HS2 is beginning to look unstoppable.

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Broadcasting policy

Not ready for prime time

The government says yes to Rupert Murdoch's bid for Sky-and to local TV

JEREMY HUNT has been culture secretary for just ten months, but he has already reshaped the media landscape. On March 3rd he in effect blessed News Corporation's intended takeover of BSkyB, the country's biggest media firm by revenues, so long as Sky News is made independent. And he wants to change television in ways that viewers will notice more. This week he also received a clutch of plans to create a new local television network.

America has local television stations affiliated with national networks, which breathlessly report car chases and carry ads for neighbourhood mattress dealers. It also has public-access cable-television channels, of the kind lampooned in the 1992 film "Wayne's World" (though not, in truth, as professional-looking). Some European countries have dozens of local channels, often paid for by licence fees.

The English, by contrast (Scotland and Wales are different), get little more than short regional news broadcasts on the BBC and ITV. These "regions" are large, often spanning several counties and millions of people. To a government that wants to reinvigorate local institutions and create a fizzing "Big Society", that seems a bit paltry.

Unfortunately, regional news is ailing. The spread of niche channels means smaller audiences for broadcasters, and thus less money to spend on reporters. The internet competes hard for advertising. During the recession ITV threatened to drop regional news altogether. Even in America, which Mr Hunt cites as a model, audiences for local news are falling. Although the government has squeezed a few million pounds out of the BBC to help local television along in the first few years, it wants its network to be self-sustaining.

How? The most fully formed proposal comes from an outfit called Channel 6. This would be a national channel with more or less local content, depending on advertising opportunities. Londoners might see two hours' worth of local television a day, residents of a medium-sized town as little as 15 minutes, probably broken into snippets. Channel 6 aims, ambitiously, to capture about as many viewers as Channel Five (ie, between 4% and 5% of eyeballs) and would spend more on production. Richard Horwood, its boss, talks of national talent competitions with local contestants being followed on local broadcasts. He reckons Channel 6 can cadge office space and expertise from local newspapers, which it could promote-though that would mean relaxing media rules.

By contrast, the Local Television Network, headed by Greg Dyke, a former director-general of the BBC, wants a non-profit network with more local content, much of it cheaply produced. The plan assumes smaller audiences-perhaps 1% of viewing. Like Channel 6, it depends on access to cheap broadcast spectrum and prominent placement on electronic TV guides.

These proposals share a conviction that truly local television cannot be made profitable. They are surely right about that. Claire Enders, a media consultant, reckons local television will perish without public money or cross-subsidy from ITV or Channel 4. Better, perhaps, to lean on them to provide more local fare than try to launch a new channel from scratch.

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Standards in state schools

Must do better

A provocative new book examines why so many children fail at school

The truth hurts

THE gap between the haves and have-nots in Britain is often clearest in the very place where the divide is supposed to be bridged: the nation's schools. The lucky few whose parents can afford to educate them privately gain good exam results and sail into university. In the state-school system, meanwhile, standards are patchy, and comprehensive schools in the poorest areas tend to get the worst results. A new book by Katharine Birbalsingh (pictured), a teacher who rose to prominence after describing the failings of the state system at the Conservative Party conference in October, helps to explain why.

"To Miss With Love" is a lightly fictionalised account of Ms Birbalsingh's experiences of teaching poor, urban children. It traces the erratic progress of pupils called Furious, Cavalier, Deranged, Stoic and Wholesome; they are steered by the teacher-narrator, Ms Snuffleupagus, whose colleagues hold dramatically different views on how to teach. "Snuffy" struggles, and mostly fails, to make her pupils realise that, once they have left school, they will have to compete for college places and jobs with luckier and better-qualified youngsters.

Ms Birbalsingh depicts what Michael Gove, the education secretary, likes to call "the soft bigotry of low expectations" (a phrase he borrowed). By choosing not to challenge poor children to behave better and work harder, she suggests, teachers condemn them to a bleak future. The evidence supports the view that failure is too readily tolerated. Almost half of all pupils leave school without passing five GCSEs, including English and maths, with acceptable grades. Yet inspectors judge most schools to be adequate: 89% of secondary schools visited last year were deemed satisfactory or better.

Teachers who criticise the comprehensive system are typically accused of undermining it. The fear is that middle-class parents who are alerted to the awfulness of their local school will opt out. There is some truth in that: rich urbanites tend to flee to the suburbs and beyond as their children approach school age. Ms Birbalsingh-whose family is Jamaican, and who was educated at a comprehensive school before going to Oxford-argues that concealing poor standards perpetuates them.

One of the reasons for the plight of the characters in her book is that their actions have few immediate consequences. Ms Birbalsingh did not get off so lightly: after her speech she was in effect suspended from her job. She later quit, and has struggled to find another post in the state sector; she is now planning to open a new state-funded "free school" in Lambeth. The school she left was already in trouble, having been judged unsatisfactory by inspectors. It has since proved terminally unpopular with parents and is due to close by 2013.

To Miss With Love. By Katharine Birbalsingh. Penguin; 293 pages; pound9.99

Bagehot

Rage against the machine

The Tories should stop blaming their woes on Whitehall

IN MAY 2010 George Osborne, the new chancellor of the exchequer, announced a modest wheeze for boosting private-sector employment: a tax break for the first ten employees of new businesses set up in Britain's poorer regions. The scheme was a "nudge", intended to tip the balance towards entrepreneurial plunge-taking in parts of the country whose dynamism had shrivelled after 13 years in a tepid bath of public largesse. Over the three-year life of the tax holiday, perhaps 400,000 employers would sign up, the Treasury guessed.

As the plan trundles through Parliament, Mr Osborne's simple idea has become a slab of red tape accompanied by 108 clauses of box-ticking explanatory notes. These include an assessment of how the scheme complies with European Union rules on state subsidies; its impact on the government's carbon footprint (none); on small businesses (positive); on race, disability and gender equality (neutral); and its compatibility with the European Convention on Human Rights (no worries there).

Alas, the entrepreneurs of Britain have mostly yet to respond. Though the tax break has been open for applications since last autumn, just 1,500 employers had applied at last count, a take-up rate described as "incredibly low" by a government source. Whitehall departments struggle to sell innovative ideas, the source says. Time and again, "what starts out as an elegant policy turns to mush."

As the Conservative-Liberal Democrat coalition nears a year in office, the word "frustration" barely captures the angry complaints being heard inside government, among Tory MPs and from the right-wing press. Many voters might look at David Cameron and his cabinet-filled as it is with smooth-cheeked sons of privilege-and see the Establishment on parade. Yet some of Mr Cameron's allies seem to feel more like insurgents against the Establishment, battling to reshape a state controlled by vested interests and an out-of-touch elite.

Cameroon insurgents know their enemies: they include the BBC, bits of the EU, left-leaning bishops, police chiefs accused of ignoring lower-level crimes that bring misery to the public, "fat cat" council bosses and health-and-education bigwigs fingered for blocking reform. Senior judges have come under unusually direct fire, with the prime minister declaring himself "appalled" by a Supreme Court ruling that sex offenders should be allowed to apply to be removed from police registers, rather than remain on them for life. Foreign Office mandarins have been chided by Mr Cameron to do

more to promote trade; by Tory MPs for counselling surrender to Brussels; and by the press for bungling the evacuation of Britons from Libya.

Prime ministers have grumbled about elites before. In her memoirs, Margaret Thatcher records how to some she was not only a woman but "that woman", offending by class as well as gender, and through what she calls her "alarming conviction that the values and virtues of middle England" could solve problems created by "Establishment consensus". In his memoirs, Tony Blair guesses that he unsettled the Establishment by being an "arriviste": neither born into the elite nor knowing his proper place. Whole chapters record his struggles with civil service "inertia", and Napoleonic schemes to drive change from Downing Street.

Yet some frustrations of the Cameroon insurgency are distinctive and new. First, there is shock at the panoply of box-ticking checks and balances inherited from New Labour-with European elements made worse by the increasing activism of judges in Luxembourg and Strasbourg. A minister who served as a special adviser in John Major's administration wistfully recalls when the government could "formulate a policy and announce it". This government, he says, has been startled by today's "tortuous" legal procedures, which have seen major planks of policy (including the June 2010 emergency budget) hauled before the high courts, accused of harming gender and other equalities.

Second, this government is trying something new: what that minister calls a "busting open of the public sector's monopoly" over the delivery of state-funded services. That is tough work; after a string of policy U-turns, Downing Street is currently beefing up its policy, strategy and press teams. The irony of driving decentralisation from the centre is not lost on senior figures.

Third, the Tories currently share power with the Lib Dems, curbing their ability to change some things that make them cross, such as human-rights laws. Some Tory exasperation with the civil service is really frustration at being in coalition, suggests a senior Blairite. Recalling his own battles to push through reform, he says that "the big arguments were not with the machine, they were with my own party."

Grow up and get on with it

Finally, thanks to Britain's horrible public finances, this is at once the best and worst of times to sell a reshaping of the state. At least the Thatcher government felt able to cut taxes as it set about privatising utilities and hacking back corporatist controls. New Labour rode an economic boom to offer the illusion that Britons could have Swedish public services and American taxes. In the worst-case scenario, voters might conclude that Mr Cameron's coalition is offering American public services for Swedish taxes.

All in all, frustration is a pretty natural reaction. And the coalition's decentralising radicalism is to its credit. Ministers have always hated pulling levers and discovering that less happens than they hoped. But the world is not always fair; voters will inevitably blame the government if the economy crashes or big reforms go wrong. Tory MPs are mostly cross that they did not win the last election outright. To win the next one, they should stop blaming others and make their plans work.

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The United Nations and Libya

An unlikely unifier

Outrage over the Qaddafi regime has given tired institutions a new lease of life

THIS has been a good week for anybody who still hopes that most of the world's nations can be induced to sign up to certain standards of decent behaviour-and then to keep their promises. Libya's despot, Muammar Qaddafi, can take the credit.

Whether they were motivated by real outrage over Colonel Qaddafi's deeds or just feared being on the wrong side of history, countries of all ideological hues have shown remarkable unity in condemning and isolating the Libyan regime. On February 25th the Human Rights Council (HRC), a United Nations (UN) body on which a rotating group of 47 countries have seats, proposed that the Libyan government be ejected from its ranks. On March 1st the UN General Assembly-which, to the horror of many, had elected Libya to the council last May-duly reversed itself and agreed without a vote to the expulsion. The only loud dissenter was Venezuela, whose envoy urged America and its allies to call off "invasion plans against Libya".

Such near-unanimity came as a surprise to those who dismiss the assembly as a dictators' club and the rights council as deeply flawed. Such critics cite the council's relentless condemnations of Israel and its cavalier attitude to free speech. Even the American ambassador to the council, Eileen Donahue, looked delighted as she emerged from the Geneva vote: she had expected a bruising debate, but the anti-Qaddafi motion had sailed through. Her boss, Hillary Clinton, also purred with pleasure when she came to Switzerland a few days later. The secretary of state said that in the Libya vote "we saw this council at its best"-although she added that the institution had plenty of shortcomings.

There was another pleasant surprise for liberal idealists on February 26th, when the UN Security Council unanimously agreed (along with other punitive measures) to tell the prosecutor of the International Criminal Court (ICC) to probe the Libyan crisis. For Russia and China, voting in favour of such a motion went against the grain. Although they allowed the ICC, in 2005, to investigate Sudan, many people believed that all subsequent efforts to send dictators to court would be resisted in Moscow and Beijing. According to Richard Dicker of Human Rights Watch, the 15-0 vote to punish and probe Libya was a vindication of the ICC's ideal: curbing crimes that "shock the conscience" of mankind.

The breadth of the anti-Qaddafi coalition is also a blessing for Barack Obama. He has taken political risks by re-engaging with the HRC-a body which the Bush administration thought too dreadful to touch-and by working with the ICC, even though America has yet to join the court.

But how many more happy surprises can be expected from the council? Given that it also counts Angola, Malaysia, Thailand and Uganda-hardly paragons of civil liberty-among its current members, disappointments may be more likely. Last week, while most people's minds were on Libya, the HRC fluffed a chance to clean up its act. After a review of its own record since it was created five years ago, the council produced a document that dashed hopes of change. Moves to give a freer hand to the UN High Commissioner on Human Rights-a job now held by Navi Pillay, a South African judge-had been blocked. Peter Splinter of Amnesty International, an advocacy group, compared the review process to an "elephant giving birth to a cockroach".

Meanwhile UN Watch, a lobby group that counters UN criticism of Israel, has gleefully recalled the fulsome praise for Libya that many council members offered when that country was undergoing a review of its performance a few months ago. Iran had "noted with appreciation" the Libyan government's new human-rights agency and its "enabling environment

for NGOs"; Syria was impressed by Libya's "democratic regime based on promoting the people's authority"; and North Korea lauded Libya's achievements "in the protection of human rights, especially...economic and social rights."

Unless something is done to interrupt the review of Libya, all these warm words, along with much harsher comments from the West, will find their way into a report due for consideration this month. Also imminent is a decision on whether to name a special rapporteur to look into human-rights abuses in Iran. Some delegations are resisting this move, arguing that governments should not be singled out against their will. Standing up to Iran may carry a higher price than kicking Colonel Qaddafi when he's almost down.

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Arctic resources

Now it's their turn

The Inuit prepare to defend their rights

WHEN in the Arctic, you should at least treat your host well. Royal Dutch Shell, an oil giant, had to learn this the hard way when planning to drill exploration wells in the Beaufort Sea off Alaska a couple of years ago. The firm had spent $84m on offshore leases and had satisfied regulators. But it failed to win over the Inupiat, an Inuit group. They worried that icebreakers and drill ships would hurt the bowhead whales on which they depend. Their leaders and environmental groups sued American regulators for not following a 1970 law on environmental impacts. This allowed them to wrest a number of concessions from Shell, including a commitment to stop all offshore operations during the bowhead migration and hunt, should drilling ever proceed.

Much has been made about conflicts between Arctic states because of a retreating polar ice cap, which will make many natural resources accessible for the first time. But so far, the disputes have been of a different kind. Shell's experience in Alaska is being repeated around the North Pole. And such clashes are bound to become even more common. Native groups claim much of the Arctic coast as their traditional territory (see map)-and are prepared to fight for their rights. In late February representatives of the Inuit met in Ottawa to discuss a common position on resource development in the High North.

In fact, countries surrounding the Arctic do not have much to argue over. The resources on land lie within clearly delineated borders and those under the sea-which include an estimated 83 billion barrels of oil, more than Russia's proven reserves today-are largely in shallow waters within the uncontested jurisdiction of coastal states. "There is no race for Arctic resources, and no appetite for conflict," says Michael Byers, author of the book "Who Owns the Arctic?" Instead of getting into a fight, he points out, Norway and Russia last year ended a decades-long dispute.

In contrast, potential for conflict with native groups is in rich supply. In particular the Inuit live in areas where natural resources are plentiful. And although they are only a small minority-an estimated 160,000 of them are spread across the Arctic-they have achieved a degree of power. Greenland, a territory of Denmark with a predominantly Inuit population, assumed self-rule in 2009, giving it control of its resources. Nunavut, a vast northern territory in Canada, was created a decade earlier by a settlement with the Inuit.

What is more, the Inuit are determined not to be bowled over. They have amplified their power by banding together in the Inuit Circumpolar Council, (ICC), a body created in 1977. They have used their membership of various United Nations bodies to compare notes with indigenous groups from around the world. They have teamed up with other Arctic dwellers such as the Sami of Scandinavia and the Dene of north-western Canada. And they have sought expert legal advice for their common position, which is due in May.

The Inuit are not against development, but want to ensure that it happens on their terms. This partly means sparing the environment-but it also means receiving their share. "For centuries the Arctic lands and waters have been exploited by everybody-except the Inuit. Now it's our turn," Kuupik Kleist, Greenland's prime minister, said at a meeting in Ottawa. The territory is counting on offshore oil and gas to speed its way to independence. It allowed exploration to proceed last year when others were hanging back after the disastrous oil spill in the Gulf of Mexico.

Other delegates spoke dismissively of companies that, a while back, had talked Inuit into bad deals. In one case a firm supplied poor communities in Russia with a crate of vodka and some food. In another a company in Canada tried to buy access to a nickel deposit in Quebec by offering cash and two ice resurfacers for the local rink.

Yet it was the Inuit success stories that most grabbed delegates. One example is the Red Dog Mine in northern Alaska. Created as a joint venture between the operator, Teck Alaska, and the local Inupiat, it has fed much cash-$146m in 2010 alone-into the Inupiat's coffers. Such deals may be too steep for the appetite of many resource companies with Arctic dreams. But the increasingly interconnected Inuit are unlikely to settle for less in one country when they know what their counterparts have received in another.

The Inuit know that they will not always get what they want-in Russia, say, where the rights of the Yupik, another Inuit group, are enshrined in the constitution but are being eroded by the government. On the other hand, events in the Middle East will only make their oil and gas more desirable. "Development is going to happen", says Edward Itta, the Inupiat leader who wrested the concessions from Shell, "whether we like it or not."

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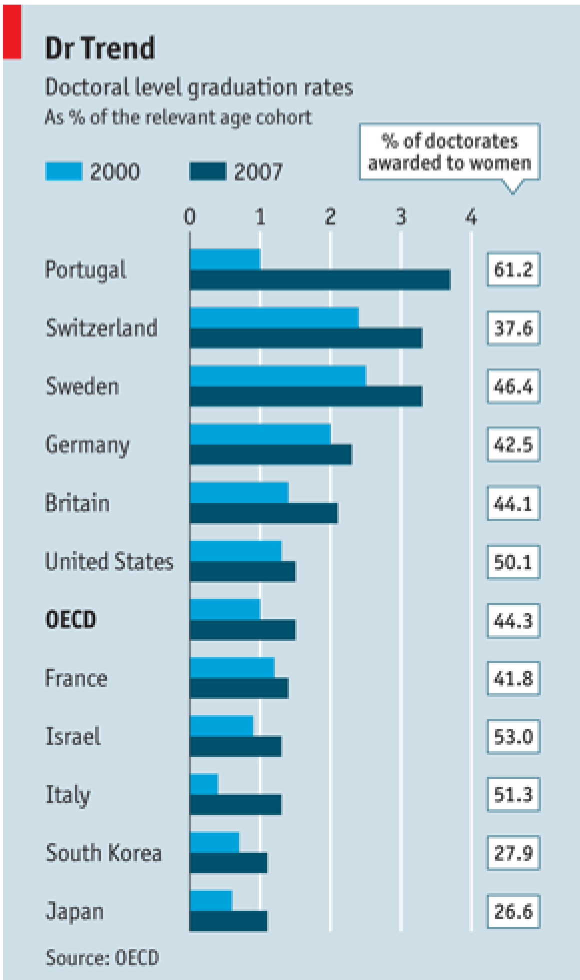
Politicians with PhDs

Doctors in the house



Doctorates are in demand all over the world, but Germany is where politicians seem to need them most. Of the members of the country's lower house, 114-or nearly one fifth-hold PhDs, and that includes the chancellor, Dr Angela Merkel. This strange love of doctorates helps explain why Germany's defence minister, Karl-Theodor zu Guttenberg, copied parts of his PhD thesis from others, leading ultimately to his resignation on March 1st. By comparison, far fewer American eggheads go into politics. A mere 18 members of the 112th Congress-around 3%-hold a doctoral degree; none of them senators. More than 100 had served in the armed forces. Still, plagiarism, if found out, does not always kill political careers. Joe Biden survived several incidents, before becoming America's vice-president. Russia's prime minister, Vladimir Putin, was accused of copying parts of his PhD thesis. So was Martin Luther King. Muammar Qaddafi's son, Saif, could soon be stripped of his PhD, too. But that is hardly his biggest worry.

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A special report on property

Bricks and slaughter

Property is widely seen as a safe asset. It is arguably the most dangerous of all, says Andrew Palmer

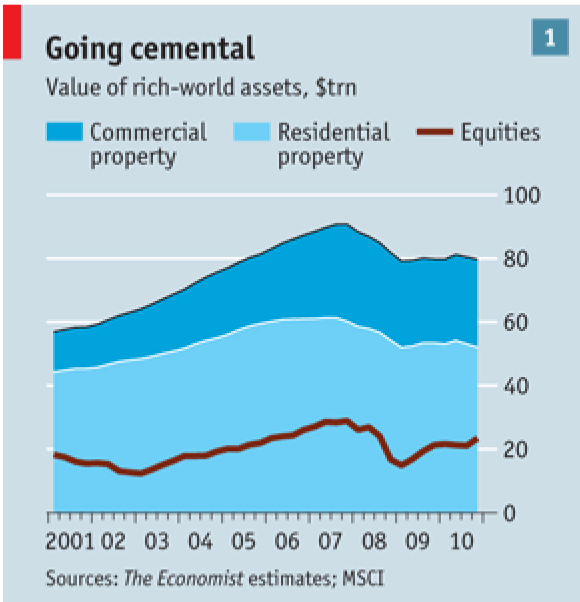
THERE are plenty of candidates, from the ghost estates of Ireland to the foreclosure signs on American homes. But as a symbol of the property cycle that still distorts the world economy, the Burj Khalifa in Dubai (pictured above) takes some beating. The world's tallest building is literally built on sand. Its height, at half a mile (838 metres), violates a basic rule of commercial property: when land is plentiful, build outward to use up as much of it as possible. The building opened in January 2010, just weeks after the emirate announced a standstill on debts largely incurred on glitzy property projects. Its name was hastily changed from Burj Dubai to Burj Khalifa to honour the ruler of Abu Dhabi for sending bail-out funds to its fellow emirate. A year on, tourists cluster at its base to take photos or to visit the observation deck; inside, many of the flats lie empty.

Dubai's record-breaker is also a powerful emblem of forgetfulness. According to Andrew Lawrence of Barclays Capital, the construction of exceptionally tall buildings is a reliable indicator of economic crises in the making. From the time the first skyscraper went up-the Equitable Life Building in New York, in 1870-to the completion of the Empire State Building (1931) and the World Trade Centre (1972) in the same city and the Petronas Towers in Kuala Lumpur (1998), great height has usually coincided with big trouble.

Mr Lawrence's theory is not perfect, but it feels right. Property moves in cycles, and the more ambitious the scale of construction on the way up, the steeper the drop on the way down. A sharp turn in the property cycle is a serious matter. The five big banking blow-ups in the rich world before the latest crisis (Spain in the 1970s, Norway in the 1980s and Sweden, Finland and Japan in the 1990s) had property at their heart. Banking crises in the developing world have also tended to happen at the peak of housing booms or just after a bust in prices.

Not all booms are alike. There were many reasons for the housing bubble that has now burst, from huge amounts of global liquidity seeking high returns to the rise of private-label securitisation. But it is striking how often property causes financial trouble. "We do not want to fight the last war," says one European banking regulator, referring to property busts, "but the fact is that we keep fighting the same war over and over."

Markets remain horribly fragile. Dud commercial-property assets clog banks' balance-sheets. House prices in America and several European markets are still falling. This special report will argue that the effects of property booms and busts can be made less damaging, but that the asset itself is inherently unsafe. Another rich-world bubble may be unlikely in the near term, but things feel very different in emerging markets. In China in particular, the worry is about another bubble that could shake the world economy. And even in developed markets, property, which many people regard as stable, will always be prone to volatility.



Why is property so dangerous? One obvious answer is the sheer size of the asset class. The aggregate value of property held by American households in the peak year of 2006 was $22.7 trillion, their biggest single asset by a wide margin (pension-fund reserves were next, at $12.8 trillion). Working out the figures in other countries involves much more guesswork. Back in 2002 this newspaper reckoned that residential property in the rich world as a whole was worth about $48 trillion and the commercial sort $15 trillion: if you allow for property-price changes in the intervening period, the current values, even after the bust, would be $52 trillion and $28 trillion (see chart 1), or 126% and 67% respectively of the rich countries' combined GDP in 2010. Whatever the precise number, property is so big that when credit conditions loosen it is likely to absorb a lot of the extra liquidity; and when something goes wrong the effects will be serious.

An even bigger reason to beware of property is the amount of debt it involves. Most people do not borrow to buy shares and bonds, and if they do, the degree of leverage usually hovers around half the value of the investment. Moreover, when stock prices fall, borrowers can usually get their loan-to-value ratios back into balance by selling some of the shares. By contrast, in many pre-crisis housing markets buyers routinely took on loans worth 90% or more of the value of the property. Most had no way of bringing down their debt short of selling the whole house. Gearing in commercial property was lower but in the boom years it still regularly touched 80-85% (it is now back to 60-65% for new borrowing in the rich world).

With only a small sliver of their own capital to protect them, many owners were quickly pushed into negative equity when property prices fell. As borrowers defaulted, the banks' losses started to erode their own thin layers of capital. "Banks are leveraged and property is leveraged, so there is double leverage," says Brian Robertson, who runs HSBC's British and European operations and used to be the bank's chief risk officer. "That is why a property crash is a problem for the banks."

Property bubbles almost always start because fundamentals such as population growth, interest rates and economic expansion are benign. A shrinking population weighs on Germany's housing market, for example, and a rising one underpins long-term confidence in America's. These fundamentals explain why many market participants are able to persuade themselves that huge price rises are justified and sustainable. Chastened regulators now talk about a presumption of guilt, not innocence, when prices look frothy. That is because property markets are inefficient in several ways which make it more likely that they will overshoot.

Cycle paths

For the lenders, property is attractive in part because it attracts lower capital charges than most other assets. That makes sense-the loan is secured by a tangible asset that will retain some value if the borrower defaults-but it can also lead to overlending. Indeed, one of the bigger ironies of the property bubble was that lenders and investors probably thought they were being relatively prudent. Capital charges are higher for commercial property than for homes but banks can still be seduced by the apparent stability of a real asset producing predictable cash flows. "Commercial real estate is often a borrower of last resort," says Bart Gysens, an analyst at Morgan Stanley. "It tends to be willing to absorb a bit more debt if and when banks and debt markets want to provide it."

Collateralised lending offers a degree of protection to the individual lender, but it has some unfortunate systemic effects. One is the feedback loop between asset prices and the availability of credit. In a boom, rising property prices increase the value of the collateral held by banks, which makes them more willing to extend credit. Easier credit means that property can sell for more, driving up house prices further. The loop operates in reverse, too. As prices fall, lenders tighten their

standards, forcing struggling borrowers to sell and speeding up the decline in prices. Since property accounts for so much of the financial system's aggregate balance-sheet, losses from real-estate busts are likely to be synchronised across banks.

Borrowers, too, contribute to the inefficiency of property markets, particularly on the residential side. Some people think that renting will enjoy a renaissance as a result of the crisis (see article), but few expect a wholesale, permanent shift in attitudes. Unlike other assets, housing is seen both as an investment and something to consume. In its latest survey of consumer attitudes in July 2010, Fannie Mae, one of America's two housing-finance giants, found that Americans wanted to buy houses for a range of reasons, from providing a safe environment for their children and having more control over their living space to making a financial return. In China there is another item to put on the list: for many young men owning a property is a prerequisite for attracting a wife.

This mixture of motives can be toxic for financial stability. If housing were like any other consumer good, rising prices should eventually dampen demand. But since it is also seen as a financial asset, higher values are a signal to buy.

And if housing were simply a financial investment, buyers might be clearer-eyed in their decision-making. People generally do not fall in love with government bonds, and Treasuries have no other use to compensate for a fall in value. Housing is different. Greg Davies, a behavioural-finance expert at Barclays Wealth, says the experience of buying a home is a largely emotional one, similar to that of buying art. That makes it likelier that people will pay over the odds. Commercial property is a more rational affair, although hubris can play a part: there is nothing like a picture of a trophy property to adorn a fund manager's annual report.

Once house prices start to rise, the momentum can build up quickly. No single individual (except, perhaps, Warren Buffett) can push up a company's share price by buying its stock at an inflated price, but the price of residential property is set locally by the latest transactions. The value of any particular home, and the amount that can be borrowed against it, is largely determined by whatever a similar house nearby sells for. One absurd bid can push up prices for lots of people.

As prices rise, property is arguably more likely than many other asset classes to encourage speculation. One reason is that property is so much part of everyday life. People do not gossip about the value of copper and tin, but they like to talk about how much the neighbour's house went for. They watch endless TV shows about houses and fancy themselves as interior designers, able to raise the price of their home with a new sofa and artful lighting. Eventually the temptation to take a punt on property becomes overwhelming. "Speculation is a bit like sex," says Robert Shiller of Yale University, a long-standing observer of speculative bubbles. "People who have lots of sex are not approved of but they are thought to live life with gusto. People eventually decided to try for themselves."

Even the risk-averse may well respond to rising prices by entering the market. Everyone needs somewhere to live, and many want to own their own homes. The amount of space that people need increases predictably over time as they find partners and have children. James Banks, Richard Blundell and Zoe Oldfield of Britain's Institute for Fiscal Studies and James Smith of RAND, an American think-tank, find that this gives people an incentive to buy early in order to protect themselves against the risk of future price increases that would make houses unaffordable.

Another reason for momentum in property markets is the fact that there are no short-sellers. If you think property is overpriced, it is difficult to profit from that view. As Adam Levitin of Georgetown University Law Centre and Susan Wachter of the University of Pennsylvania pointed out in a recent paper on the causes of the housing bubble in America, it is impossible to borrow the Empire State Building in order to sell New York real estate short. HSBC probably came closest by selling its Canary Wharf tower in London for pound1.1 billion ($2.18 billion) in 2007 and buying it back from its debt-laden Spanish owners for pound250m less in late 2008-the greatest short sale in the history of property, says one observer. Some investors infamously did make money from betting against American subprime mortgages, but their real achievement was to find a way of doing so, by buying up credit-default swaps that paid out when mortgage-backed securities soured.

There have been attempts to create instruments that allow property to be hedged or shorted. Mr Shiller himself has been involved in launching derivatives linked to home-price indices for both large and small investors, but with limited success to date. Commercial-property derivatives, however, are gaining ground.

Such products are conceptually appealing but face several obstacles. Some are common to all financial innovations: new products lack enough liquidity to lure buyers in, for example. Others are more specific to property. Individual properties and neighbourhoods differ, which makes it hard to construct accurate hedges. Government interventions to shore up the housing market add an extra element of unpredictability. And since house-price cycles tend to last for a long time, says Mike Poulos of Oliver Wyman, a consultancy, it can be expensive to sustain a short position.

Up, up and away with the fairies

The effects of buying a home when prices are rising are insidious. A 2008 paper by Hugo Benitez-Silva, Selcuk Eren, Frank Heiland and Sergi Jimenez-Martin used the Health and Retirement Study, a biennial survey of Americans over the age of 50, to compare people's estimates of the value of their homes with actual values when a sale took place. The authors found that homeowners overestimate the value of their homes by an average of 5-10%. Those who had bought during good times tended to be more optimistic in their valuations, whereas those who had bought during a downturn were more realistic. Expectations of higher prices explain why bubble-era buyers were more willing to buy risky mortgage products and take on ever greater quantities of debt. The amount of mortgage debt in America almost doubled between 2001 and 2007, to $10.5 trillion.

The rich-world buyers of today ought to be more realistic about the future value of their homes, but attitudes are deeply entrenched. When asked to rate the safety of various investments, two-thirds of the respondents in the Fannie Mae survey classed homeownership as a safe investment, compared with just 15% for buying shares. Only savings accounts and money-market funds, both of which enjoyed an explicit government guarantee during the financial crisis, scored higher than homes. Homeowners who were "under water" on their mortgages (ie, they owed more than their properties were worth) were just as sure as everyone else that housing was a safe investment.

If the Burj Khalifa shows that memories of property cycles are short, the Fannie Mae survey suggests that some of the lessons are never taken on board at all. Given the state of residential property around the rich world, perhaps the victims are suffering from post-traumatic amnesia.

Listen to an interview with the author of this special report

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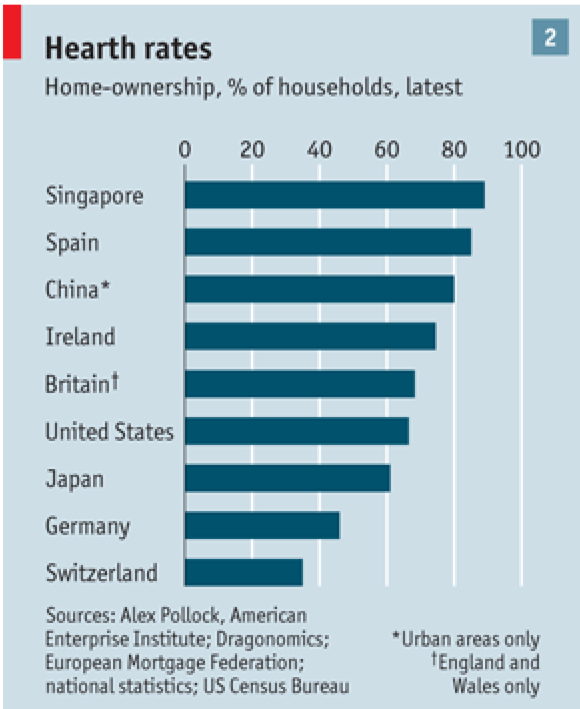
Own goal

Renting is becoming more popular, but only up to a point

"THE psychology of the consumer has changed 180^ from the bubble," says Ric Campo, the boss of Camden Property Trust, an American real estate investment trust (REIT) specialising in multi-family residential blocks. If homeownership was the American dream before the bust, lots of people are now waking up to the benefits of renting. Until the bubble got going, the "move-out rate" (the percentage of Camden's tenants leaving their apartments each year to buy a home) was about 12-14%. That rose to a peak of 24% when, as Mr Campo puts it, the banks started lending to anyone who could fog a mirror. It is now down to around 10%.

An analysis of relative returns from home-ownership and a portfolio of other investment assets by Eli Beracha of East Carolina University and Ken Johnson of Florida International University suggests that for most of the past 30 years it would have made economic sense for Americans to rent rather than buy. Their study necessarily makes lots of heroic assumptions-most notably, that renters will be utterly disciplined about investing the cash they save by not buying a home. Still, it is a useful corrective to the widely held belief that renting is a waste of money.



Political rhetoric in favour of home-ownership has fallen silent. Other countries have achieved the same or higher rates of ownership as America without destructive government subsidies (see chart 2). Plans to wind down Fannie Mae and Freddie Mac, the government-sponsored mortgage giants, are now on the table. If more people rent, house prices should become less volatile.

The social rationale for encouraging Americans to buy their homes-that ownership makes for more engaged citizens whose children do better at school-looks weaker than it did. A 2009 paper by David Barker of the University of Iowa and Eric Miller of the Congressional Budget Office points out that many of the "benefits" of home-ownership disappear when other variables, such as employment, are controlled for. In a separate piece of work, Grace Bucchianeri of the Wharton School of Business found little evidence that homeowners were happier than renters.

Whether any of this justifies talk of a "rental nation" is doubtful. America's home-ownership rate has dropped from 69.2% at its peak in 2004 to 66.5% in the fourth quarter of 2010. That is its lowest rate since 1998 but still a long way from that of Germany, which was only 46% in 2007. Switzerland's figure is even lower.

These gaps reflect entrenched differences. Some of them are cultural. "A commute of an hour is unacceptable in Germany," says Sascha Hettrich of King Sturge, a property adviser in Berlin. That pushes people toward the rented apartment blocks which predominate in city centres, especially when, as in Berlin, rents are very low. Other factors are institutional. German mortgage lending is a pretty conservative affair, making it hard for people to get onto the ladder without lots of cash to put down. And German tenants get plenty of protection from their landlords. Leases are open-ended and rent increases are controlled by a system pegging rents to those charged for comparable properties. Conservative investors feel safe in the knowledge that demand for properties is high and income is stable.

In America the crisis marks a structural change for a swathe of consumers who should not have bought properties in the first place and will not be able to in future. But home-ownership rates are unlikely to drop much more, not least because lower prices have made houses more affordable. Messrs Beracha and Johnson reckon that, unusually, buying just now makes more financial sense than renting. In a speech last September John Paulson, a hedge-fund manager who made billions betting against the housing market, urged people to get back into the market: "If you don't own a home, buy one. If you own one home, buy another one, and if you own two homes buy a third and lend your relatives the money to buy a home." Assuming you have the cash.

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When the roof fell in

Housing will be a drag on the rich world's recovery for the foreseeable future

Walls of worry

PROPERTY can cause huge problems, but the sector also traditionally leads economies out of recession. Housing is far bigger and more important than commercial property. Residential investment, which is driven by new housing starts, makes up a large chunk of the volatile bit of the economy. That means changes in residential investment have a disproportionate impact on rates of GDP growth. It has played a big part in driving previous post-war American recoveries, and many assumed the same would happen this time round. Things have not worked out that way (see chart 3).

Around much of the rich world, hopes that housing markets would be well on the road to recovery by now have been disappointed. Not everyone is glum. Renters are not bothered by falling prices, and the cash-rich are still having a high old time (see article). But for most people property is a source of worry.

In America the bounce caused by a temporary tax credit for first-time buyers has long since faded. The latest S&P/Case-Shiller home-price indices (which take in figures up to December 2010) showed that prices had fallen in 19 out of 20 cities covered month-on-month, and that the composite index had declined by 2.4% year-on-year. Eleven markets, including Miami, New York and Seattle, hit their lowest levels since prices first started falling in 2006.

Misery index

In Britain a strong start to 2010 also weakened as the year went on. Figures from Nationwide, a lender, showed a 1.1% year-on-year fall in prices in January, the biggest slide since August 2009. In Spain the IMIE index showed a fall of 3.9%

in December, taking prices back down to levels last seen in 2005. For sheer awfulness nothing can touch Ireland, where prices dropped by 10.8% in the fourth quarter and the rate of decline increased.

It comes as no great surprise that many markets are still struggling. A common thread in many rich-world economies is uncertainty about the future. Policymakers may worry about the effect of housing problems on unemployment-homeowners in negative equity may not be able to move in search of jobs-but the more important effect runs the other way. Changes in hiring rates are an excellent predictor of homeowners falling behind with their mortgage payments. Fears about sovereign-debt crises, the effects of austerity programmes and job security make it far less likely that people will take the plunge on buying a new home.

Another common feature is a squeeze on mortgage finance. The private market for securitised mortgage loans remains very subdued. Banks have belatedly tightened credit standards, particularly for first-time buyers, who lubricate the housing market for everyone else. According to recent research in Britain by the Home Builders Federation, a trade group, the average first-time buyer aged 30-39 would now have to save 35% of his or her pay after tax every month for five years to scrape together a deposit. Many are turning to the bank of Mum and Dad for help.

In America the government has rushed in to take up the slack. Fannie Mae and Freddie Mac, which buy home loans from lenders, and the Federal Housing Agency (FHA), which insures them against default, between them routinely guarantee more than 85% of new home loans. FHA-insured loans are particularly important for first-time buyers, who need to put down a deposit of only 3.5%. The market is so dependent on these agencies that the government will not be able to withdraw its support any time soon (which is one reason to expect the winding down of Fannie and Freddie to be slow in coming).

Even so, there is a limit to governments' willingness to take on more risk. Fannie and Freddie have been fighting with the banks about poor-quality loans they originated and then passed on to the agencies. The FHA has gradually been tightening its insurance criteria. Add in the fallout from the "robo-signing" scandal, in which banks were accused of using flawed and possibly fraudulent foreclosure processes, and mortgage approvals will stay sluggish.

Much as these demand-side factors dampen the housing market, the supply side arguably has an even bigger effect on prices. Work on the relationship between housing supply and bubbles by Edward Glaeser of Harvard University and Joseph Gyourko and Alberto Saiz of the Wharton School suggests that places with relatively elastic supply have fewer bubbles, of shorter duration, than those where the supply is more restricted.

Dearth and homes

In many respects the recent boom bears this out. Differences in supply constraints can explain much of the striking disparity between American states, from the modest run-up in prices in Texas, where land is easily available, to the huge surge in places like Nevada, where land-use regulations are tighter.

But elasticity is not always a good thing. When the housing market can respond to demand by adding to supply, there is a greater risk of overbuilding. In theory, booms in elastic markets do not last for long because as new housing becomes available it puts pressure on prices, puncturing expectations of further appreciation and popping the bubble. For the 1996-2006 cycle in America Messrs Glaeser, Gyourko and Saiz find that places with more developable land did have shorter booms.

But when it comes to the biggest house-price bubble in history, theory does not get you very far. In some places the boom was big enough and irrational enough to suppress price signals from lots of new supply. Instead, availability of land simply fed speculative activity, which has made the popping of the bubble much more painful.

In a report last December the Bank of Spain reckoned that the country has a glut of 700,000-1.1m unsold homes, which will continue to weigh on prices this year. Bernstein Research estimates that these unsold houses will take four to five years to clear, and even that may be too optimistic given high unemployment, the threat of a sovereign-debt crisis and fewer immigrants. It could have been worse: Spanish banks have repossessed huge amounts of land that had not yet been built on, and residential-mortgage standards are rather conservative. But the oversupply means that prices will keep falling. They have dropped by only 16% from their peak in real terms, and Bernstein reckons the eventual fall will be more like 30%.

Ireland's building boom also went over the top. The government relaxed planning laws, the banks threw money at anything involving cement, and investors gobbled up houses in the expectation that prices could only go up. An Irish government report last October into the country's "ghost estates" identified more than 2,800 housing developments where

construction had been started but not completed. Between them these estates had planning permission for 180,000 units, which roughly translates into a new residence for one in every 25 Irish people.

A lot of properties were sold before the market soured, so the report found only 33,000 finished homes remained empty, not the hundreds of thousands forecast earlier. But even if the overall number of unsold units is not as bad as feared, it does not capture the full effects of oversupply.

Take Clongriffin, a huge mixed-use development north of Dublin. The location is good, about 15 minutes from the city centre. Flags extolling "Dublin's new town centre" hang from lamp-posts outside the local railway station, which opened in 2010. There are some shops on the main street, and cars in many of the driveways. But the overall impression is bleak. Many shops are unoccupied, lots of apartments lie unfinished and there is no sign that work is continuing. Hoarding surrounds large tracts of undeveloped land.

Ghosts of Ireland's boom

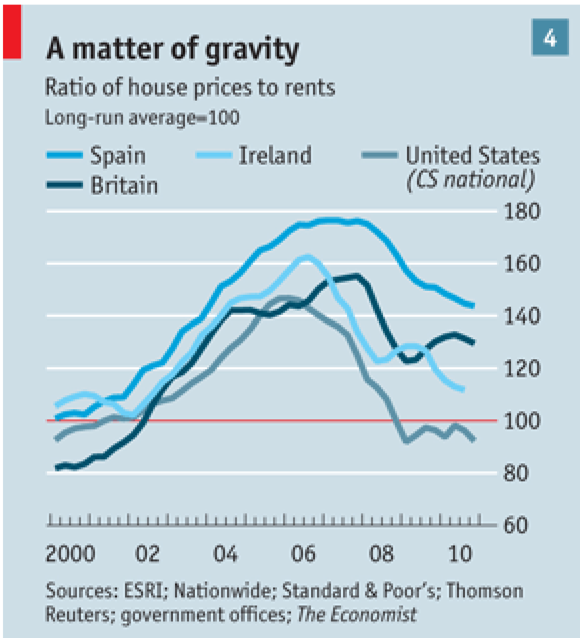
Mixing vacant and unfinished properties with occupied ones drags down the value of everything. The bust also gives developers very little incentive to resolve disputes over maintenance. Clongriffin is one of a number of north Dublin developments involved in legal cases over buildings contaminated with pyrite, a mineral that crumbles as it oxidises.

Clongriffin may also have the wrong sort of properties for this stage of the cycle. During the boom much of the construction activity was in flats. Developers liked them because they could generate more revenue from a single plot of land. First-time buyers saw them as a way to get onto the housing ladder, perhaps hoping to trade up to a house later. But prices have now fallen so far that buyers can skip the flat and go straight to a family home.

Clongriffin's unsold units will probably find buyers in the end, thanks to its location. Two-fifths of Ireland's population lives in greater Dublin and the country has one of the highest proportions of 25-45-year-olds in Europe, most of whom will want to own their homes. But lots of the excess was in more rural areas. Marie Hunt of CB Richard Ellis (CBRE), a property consultancy, points out that in such places even an oversupply of 20 homes can make a big difference.

Only in America

Oversupply can take many forms. America's big housing worry is its huge "shadow" inventory-homes whose owners are seriously behind with their mortgage payments or in foreclosure and which will eventually come onto the market. Even though American house prices are now back at fair value (ie, the ratio of house prices to rents is back to its long-run average), this pipeline of distressed properties is putting prices under continued pressure.



A matter of gravity
Ratio of house prices to rents
Long-run average=100
Sources: ESRI; Nationwide; Standard & Poor's; Thomson Reuters; government offices; *The Economist*

It also helps explain why America has suffered such a sharp fall in prices after the bust despite peaking lower than many other countries (see chart 4). House prices are generally "sticky" on the way down, in part because people are averse to selling at a loss. But America's bust has brought waves of distressed sales, forcing prices down rapidly. Around a quarter of borrowers are now in negative equity. "The big question is not how fast prices rose but how fast and how much they fell," says Eric Belsky of the Joint Centre for Housing Studies at Harvard University.

One explanation is that unemployment in America rose more sharply than in other rich economies, and even creditworthy borrowers cannot cope with a sustained loss of income. But the initial drop was down to causes more specific to housing. The most obvious culprit was the extraordinary laxity of America's mortgage-underwriting standards in the later stages of the boom. With very little equity in their homes to protect them from a drop in prices, lots of high-risk borrowers quickly became submerged when the bubble burst. Housing boffins regard negative equity as the best predictor of default, which is why they take loan-to-value ratios very seriously. It is also what saddles banks with losses when homes end up in foreclosure.

A related issue is the amount of "strategic defaulting" in America: the number of people choosing to walk away from their homes. Its prevalence can be exaggerated, but it has still come as a surprise. Before the crisis the conventional wisdom had been that people would do whatever they could to stay in their houses, giving priority to mortgage payments over all other forms of debt. But Andrew Jennings of FICO, the company behind America's FICO credit scores, reckons that 25-30 of defaults are now premeditated. He says that many borrowers, often nominally lower-risk ones, prepare for default by making more credit inquiries and taking up other loans. The practice is more widespread in the many American states where lending is "non-recourse", meaning that lenders cannot come after a defaulting borrower for any debt left over when the property is sold.

In Europe's frothier markets unpaid debt hangs around the necks of borrowers, giving them a bigger incentive to tough it out in their homes. Speculative purchases also made things worse: people are more likely to give back the keys to homes they are not living in. The report of the Financial Crisis Inquiry Commission pointed out that by the first half of 2005, the peak year for housing sales, more than one in every ten house sales in America was for an investment or a second home.

Housing, flat

Whatever the reasons, the number of properties that have gone into negative equity and into foreclosure is much greater than expected. A system set up to deal with 500,000 foreclosures a year is now running at about 2m a year, says Michelle Meyer of Bank of America Merrill Lynch. Just how bad this glut of unsold houses will get is very hard to say. It depends, above all, on the unemployment rate. But it also depends on the speed and outcome of the foreclosure process and on the efficacy of official interventions. The experience to date has been uninspiring. A government programme to modify mortgages, giving struggling homeowners a subsidy on their payments, has had $50 billion allocated to it, but so far only $1 billion of that has been spent. Many of those who have had their mortgages modified wind up defaulting again.

Sean Dobson, the chairman of Amherst Securities, is more bearish than most. He argues that some 11.5m American homes (out of 125m in all) remain at risk of ending up in foreclosure, and that principal forgiveness for borrowers under water is the only option: "You are not going to create new buyers for 11m homes, short of legalising every illegal immigrant and forcing them to buy a house."

Others are less apocalyptic, particularly as America's recovery gathers pace. But the pipeline of distressed homes heading for the market will keep prices down for some time yet. Sandipan Deb of Barclays Capital reckons that the number of such properties probably totals around 4m-5m. He says that prices will fall by 6% or so in 2011 and will then languish for a while before gradually recovering. That may be just what policymakers want. "The objective of the government is to make sure that distressed stock does not hit the market suddenly," says Mr Deb. Modifying home loans may not avoid defaults altogether, but it should at least space them out.

Despite the woes, America's system of long-term, fixed-rate mortgages at least ensures that borrowers do not have to worry about interest rates. Many European countries have adjustable-rate mortgages that move in step with changes in official interest rates: two-thirds of the outstanding mortgages in Britain, for example, are of this kind. Much as European borrowers have been helped by ultra-low interest rates so far, they will also be exposed to rising costs when rates go up again. With house prices in Europe having fallen less far, austerity threatening higher unemployment and inflationary pressures prompting hawkish talk about tighter monetary policy, the continent's housing markets look more likely to suffer new shocks than America's.

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A world apart

International buyers are still splurging on residential property

CONCEIVED during the boom and taken over by its lenders after the bust, the Icon Brickell has become the most visible symbol of Miami's property renaissance. The Philippe Starck-designed condominium complex is, depending on taste, either hugely sophisticated or utterly naff. The columns at the base of the building are shaped like Easter Island statues (see picture); tables and chairs sit voguishly in the water of an outdoor pool; the walls of an enormous spa are lined with books wrapped in white paper. It's seductively ridiculous.

The complex had been largely pre-sold, but when the bottom fell out of the market buyers refused to pay up. Units are now being marketed at heavily reduced prices. Sales, at around 60 units a month, are running at twice the expected level, says one agent. The main source of demand is cash-rich international buyers, most of them from Latin America. Local agents say Venezuelans are the most active buyers, followed by Brazilians.

International money is flowing to other properties in the city, too. Figures from the Miami Association of Realtors, a trade group, show that sales of condominiums in Miami in 2010 were more than 40% up on the previous year. "The foreign and,

especially, the Latin American buyer has been a big factor in the remarkable turnaround in sales velocity," says Jubeen Vaghefi of Jones Lang Lasalle (JLL), a property consultancy.

The flow of cash from abroad reflects many factors. The appreciation of currencies such as the real, allied to the fall in prices, has made places like Icon Brickell look good value relative to posh properties at home. Miami is the natural gateway into America for Latin Americans. Security is another draw: the kids are unlikely to be kidnapped.

Miami is one of just a few cities around the world that attract international buyers. In Hong Kong the market is buoyed by people from the mainland who slap down wads of cash. Even Dubai still attracts money from less stable places such as Iran and Iraq.

London is the most international city of all. Last year it pulled in cash from Europe as the pound weakened against the euro, as well as buyers from the Middle East, North America and Asia. According to Knight Frank, an estate agent, in the 12 months to June 2010 half of all newly built flats in central London were bought by foreigners. At The Lancasters, an opulent residential development nearing completion on the north side of Hyde Park, the split of sales to date is more like 60-40 in favour of foreigners.

Prices have proved as resilient as demand. At One Hyde Park, a starry new development which officially opened in January, some units have reportedly sold for more than pound6,000 ($9,625) per square foot. Klas Nilsson, the boss of Northacre, the company behind The Lancasters, says the credit crunch has not hurt either sales or prices. Indeed, it has helped: with few other such developments under construction, there is less competition.

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Prime numbers

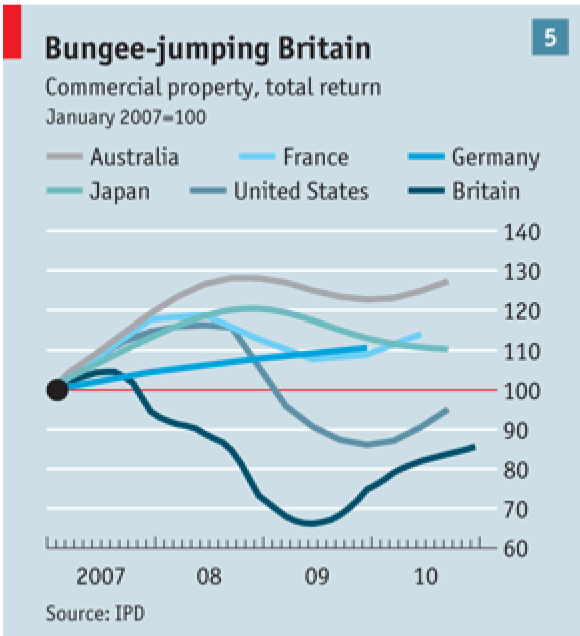
Commercial property has bounced back, but only in the best locations

Shard ascending

IN SOME corners of the commercial-property market a slight whiff of self-congratulation is in the air. Doom-laden warnings issued in 2008 and early 2009 that commercial real estate would be the "next shoe to drop" have not come to pass. Opportunistic investors hoping to cash in on the sale of distressed assets have been largely disappointed. Governments have intervened less than they have in housing (there are fewer votes in office buildings and shopping centres). "Commercial real estate was not at the heart of the crisis," says a big fund manager in Germany.

Investors' interest in the asset class is growing, thanks in large part to the extreme macroeconomic environment. Near-zero interest rates make the yields on offer from property look attractive. The cashflow from tenants is more stable than that from equities, where values zigzag day by day and dividends can suddenly be suspended by the management. And unlike many types of bonds, property is seen as a useful hedge against inflation because rental agreements can be renegotiated with tenants to reflect rising prices. Bulls note that Norway's $543 billion state pension fund, one of the world's largest sovereign-wealth funds, is starting to allocate money to property. It made its first real-estate investment in January, spending pound452m ($723m) on properties in London's Regent Street.

Led by Britain, which had seen the steepest fall of the big property markets (see chart 5), values are rising again. According to IPD, which provides information on property markets, British commercial property delivered a total return of 15.2% in 2010, its strongest performance for four years. Investing in property has paid off handsomely for many since late 2009. Global REITs performed twice as well as global stocks and bonds in the 12 months to the end of September 2010. Take a closer look at this resurgence, however, and the picture becomes more complicated.



In one crucial respect, the bubble in commercial property was less dangerous than in the residential sector: there was no development boom and hence no oversupply. The enormous amount of liquidity sloshing around the system was directed at acquiring existing properties rather than building new ones. "This was an excess of capital, not an excess of cranes," says Jonathan Gray, the boss of Blackstone's real-estate business.

That flood of money drove up debt burdens and property values and reduced yields (the ratio of the income flow from a property to its value). Madness became routine: the 110% loan-to-value financing for a hotel in Germany, offered to a borrower with no knowledge of either hotels or Germany; the fact that yields on Grafton Street in central Dublin, hardly a retail paradise, came close to those in some of the world's most prestigious shopping streets; the willingness of staid fund managers to base their investment case on capital gains rather than rental growth.

If the market had been left to run for a little longer, it might have become crazier still. Just before the crisis broke, there had been talk of securities made up exclusively of riskier development loans. But in contrast to the overbuilding of the early 1990s, when rapid rental growth persuaded developers to dig lots of holes in the ground, this time lenders and investors were disciplined enough to want income-producing properties; they were just not disciplined enough to price the risks correctly.

Indeed, if there is going to be an imbalance in commercial property now, it is more likely to involve a scarcity of supply. As prospects for economic growth gradually improve, demand from large companies, which are sitting on lots of money and are able to take a long-term view of the business cycle, is picking up. Yet there is very little development in the pipeline, at least in the rich world. Estimates from CBRE show that 65% of the new office space due to come on stream in big cities between 2010 and 2012 is in Asia and just 8% in North America. As a result, says Brett White, the firm's boss, vacancy rates will go down and rents, which have already stabilised in many places, will go up: "Power is very quickly shifting from the tenant to the landlord."

Some are well placed to benefit from a prospective squeeze on space. A cluster of new buildings is going up in London, with nicknames like the Shard, the Walkie-Talkie and the Cheesegrater. Francis Salway, the boss of Land Securities, a big developer, says his firm made a conscious decision at the start of 2010 not to be too risk-averse. It has since committed itself to development projects costing over pound1 billion. Mr Salway reckons that there could be a shortage of new office space in London by the end of this year; completion of his next project in the city is not due until 2012.

Quality streets

Outside London, the chances of an immediate surge in new building are slight. Debt financing for development projects, which lenders inevitably class as risky, is very tight. Land Securities has been able to start building in part because it raised lots of equity during 2009 and in part by joining with others. The Walkie-Talkie building, work on which started in January and is due to be completed in 2014, is a joint venture with Canary Wharf Group. And London is arguably a special case: the city's leases tend to be unusually long, often 25 years, which means that tenants in old offices whose leases are due to expire in the next few years may want to up sticks for a modern building.

In any case, all this talk of rising values and space constraints can be misleading. The recovery in commercial property is confined to the best, or "prime", assets. Prime is an overused word in the industry, but in essence it means the best

buildings in the best locations, with good tenants and long leases. For offices, that means buildings right in the centre of big, international cities. For other types of commercial property it might mean something different: a great logistics centre with a long lease, for instance, might be near a motorway and nothing much else.

In the boom the distinction between top-quality assets and lower-quality ones (also known as "secondary" and "tertiary") blurred. Money chased property of all sorts, closing the yield gap between the best and the rest. Not any more. Investors are now generally much more conservative, in part because they have more of their own equity at stake. That points them towards big cities where it is easier to get into and out of investments and where demand from high-quality tenants is concentrated. Money that had been raised to buy distressed assets was also switched into safer ones when it became clear that bargain properties were not coming to market in great numbers (of which more below).

In a faint echo of the boom itself, this weight of money chasing "safe" assets carries risk. Some think that prices for prime properties have already bounced back too far. "The next bubble may be under way in some markets," says Matthias Danne of Deka, the largest provider of open-ended property funds in Germany. Correlations also tend to go up when property companies chase the same sort of tenants and locations: a portfolio of city-centre office buildings full of blue-chip banks looked stable until the crisis. And the desire for secure, long-term leases can easily backfire if interest rates rise, which will make yields look much less appealing. "A real snapback in interest rates is the big real-estate risk," says Mr Gray at Blackstone.

Blackstone's strategy is to invest opportunistically: it looks for empty and run-down buildings that it can improve and sell. For less ambitious investors, the obvious way to find better-value properties will be to take on risk gradually. That might mean accepting shorter lease lengths, with a view to refurbishing a building on expiry and then increasing rents. It might mean staying in the biggest cities but plumping for lower-quality assets, or moving into the best locations in secondary cities. Or it might mean going for the very best assets in less attractive countries.

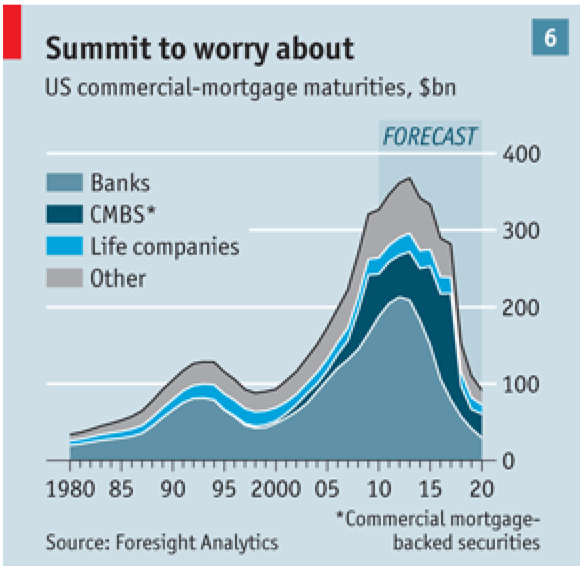
Some fund managers make the case for prime properties in Spain. In December Deka bought a shopping centre in Bilbao for euro116m ($153m). Mr Danne reckons that its location and age (less than three years), and rents that were set in 2008, when tenants had the upper hand, provide plenty of scope for future growth.

Even the most troubled markets have pockets of promise. International retailers see a chance to get their hands on really good locations at really low prices: Walt Disney announced plans in October to open its first store in Dublin during the first half of this year, for example. And high vacancy rates are not the same as an excess of high-quality office space. Even in Dubai, where the sky is still alarmingly full of cranes and half-finished towers, one Western bank is contemplating building a new office for itself because existing buildings are not up to scratch.

The long tail

Froth at the very top of the market and signs of life on the next rung down are all very well. The real problem in commercial property in much of the rich world is the vast number of properties in less auspicious locations. It is hard to find out exactly how these properties are faring now, but one thing is clear: they were the assets whose values moved furthest from fundamentals during the boom. They tended to be loaded up with more bank debt, in part because better properties went for financing from capital-markets investors. And they have not benefited from the recovery in prices.

Investors had assumed that this would mean a flood of properties coming onto the market as owners tried to offload their buildings and borrowers breached their covenants. Yet there has been very little activity at the lower end of the market. There is still a big gap between the prices that owners want and that bargain-hunters are prepared to pay, which is holding up deals. Many banks have been willing to roll loans over and ignore breaches of loan-to-value covenants caused by falling values (a strategy known as "extend and pretend") rather than force a sale. Low interest rates have helped borrowers to keep up with loan payments. That leaves large parts of the market in limbo, producing enough cash from tenants for owners to stay alive and lenders to forbear but with little prospect of an immediate recovery in values.



How long can this last? There is still a huge amount of debt attached to commercial property, and most of it is coming due in the next few years. A 2010 report by the Congressional Oversight Panel showed that around $1.4 trillion of loans backed by commercial property will mature in America alone by the end of 2014 (see chart 6). Another $1 trillion is due to mature by 2018, much of this second wave in commercial mortgage-backed securities (CMBS).

Refinancing that amount of debt will be very tricky. Banks are still under pressure to bring down the size of their balance-sheets. Debt markets are thawing, but slowly. Around $15 billion of CMBS were issued in America last year, and according to Tom Fink of Trepp, a research firm, that number is likely to rise to $30 billion this year and $50 billion in 2012. He reckons that the market will have to issue $100 billion a year by the time the CMBS wave breaks in 2014-15. Other markets will face similar pressures: Ian Marcus, chairman of Credit Suisse's European property arm, says that around pound40 billion of bank debt and CMBS will need to be refinanced in Britain each year for the next four years, but that lending capacity from banks and other sources totals only pound15 billion-20 billion annually, and that figure might well drop further.

The better borrowers and properties clearly have the best chance of surviving the refinancing tsunami. Rising prices for prime assets help close the financing gap between loan and equity values. According to Foresight Analytics, a research firm, at current values half of the debt coming due this year in America is in negative equity. A 10% increase in prices would reduce the proportion of under-water debt to under 30%. Providers of debt and equity naturally cluster at the top end of the market.

Getting out from under water

For the long tail of inferior buildings, a slow, stumbling slog towards normality is the most likely outcome. The biggest fear in the market is that banks will foreclose on borrowers and start a fire-sale. But dumping assets would risk setting off another downward spiral in prices, eating into the amount of capital in the system. "In principle, assets should be sold, but in practice lenders may not benefit, and there may be very nasty ripple effects that no one wants to see happen," says Nick Scarles, the chief financial officer of Grosvenor, a British property company.

The picture is further complicated by interest-rate swaps that many borrowers took out to protect them against rate rises. These swaps often extend well beyond the life of the loan. Until rates rise, the cost to the banks of unwinding them is high enough to act as a drag on disposals.

Sitting on assets for ever is not an option either. The interest-rate cycle could turn, which would put more pressure on borrowers and tenants and quickly eat away at banks' profits. And as leases get closer to their expiry dates, their value erodes. Most importantly, buildings need love if they are not to deteriorate. Under-water owners of property in poor locations have little incentive to splash out on maintenance. "There is a horse race between the economic recovery doing its job and lower-quality properties heading for obsolescence," says one regulator. With austerity packages kicking in across much of the rich world, it is a race many buildings will lose.

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The old and the new

The crisis has spurred innovation in commercial property

Golden oldies

UNLIKE their cousins in residential property, professionals in the commercial sector are not searching their souls after the crisis. Property is cyclical, they shrug. The basic drivers of demand are unchanged, and supply did not get out of hand. Now is a time to pick up bargains. But beneath the cyclical rhythms, the crisis has left its mark.

First, the industry's cast has changed. Both its asset-management and its financing sides have been winnowed out, thanks to the disappearance or withdrawal of several big banks. ING, a Dutch bank that has been told to lose weight by European regulators, sold most of its huge property fund-management arm to CBRE in February, for example. Further consolidation lies ahead. New sources of financing such as insurance companies are emerging to replace banks constrained by legacy loans and regulation.

Second, the crisis showed investors that some parts of the industry are more liquid than others. Those in listed REITs were able to sell out more quickly than those in unlisted vehicles; larger REITs and listed developers managed to raise equity during the crisis. At present only about 15% of real-estate assets are in REITs, says Ted Bigman of Morgan Stanley Investment Management, but their share could rise in future.

Third, the violent swings in value of the past few years have speeded up the development of commercial-property derivatives. Paul Ogden is a founder of inProp Capital, which manages a new fund that offers investors synthetic exposure to an index tracking the British market. He argues that with lots of investors looking at real estate but not many prime properties coming up for sale, derivatives offer a way to get quick and accurate exposure to the asset class. They can also be used to hedge and reduce exposures swiftly. The market is still tiny, but if it works well it has the potential to become enormous.

Lastly, the crisis highlighted what should have been obvious all along: that some types of properties are more resilient in the face of an economic downturn than others. The big example is the polarised performance of prime and secondary assets. But there are other, less glaring ones. Greenery had a good war. Buildings account for 30-40% of carbon emissions in industrial countries, and according to Colin Dyer, the boss of JLL, interest in energy-efficient properties did not diminish during the downturn. The Empire State Building is the flagbearer for the trend: the iconic New York skyscraper is in the finishing stages of a retrofit that will cut its emissions by almost 40%.

Commercial property that flows with the tide of demography has also tended to do better than the rest. In America prospects for the "multi-family apartment" rented sector are helped by the "echo-boomers", a youthful bulge in the population. At the other end of the age spectrum are accommodation and health-care facilities for elderly people. The over-85s are the fastest-growing bit of America's population, says Debra Cafaro, the boss of Ventas, a REIT with a

portfolio of nursing homes and private housing communities for the elderly. But the supply of such places is limited, which helped cushion the downturn. Property is often billed as a way of diversifying investment portfolios, but some parts of the industry are clearly more diversified than others.

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Building excitement

Can China avoid a bubble?

Don't look down

THE property market illustrates the growing divergence between rich-world and emerging economies. In most developed countries (with a few exceptions, such as Australia and Canada) governments are trying to breathe life into property. In developing ones they are trying to cool things down. In the West the question is when prices will stop falling. In the East it is whether they will stop rising.

For many institutional investors, emerging markets, however buoyant, are not worth taking big bets on. Thanks to the bust, the rich world offers high-quality properties in liquid markets at lowish prices. The developing countries are a riskier development prospect, with new homes, offices and malls being built at speed to cope with fast-rising demand.

That demand is undoubtedly enormous. Brazil is thought to be short of some 8m homes; the whole of India has fewer hotel rooms than Las Vegas; in Saudi Arabia a long-awaited mortgage law is expected to kickstart a residential boom. Yet the pitfalls are also cavernous. Legal issues are one source of uncertainty. Investors complain that China's system is capricious, for instance. "China will be one of the biggest property markets in the world in five years' time," says one big fund manager. "But if you put millions into a building in China and sell it, it is not clear that you will be able to take your money out." Retail lenders express similar misgivings about the process for repossessing homes in developing markets.

The biggest worry of all is the rush of new supply. The pace of development is often frantic, nowhere more so than in China. According to Barclays Capital, more than 40% of the skyscrapers due for completion in the next six years will be in China, increasing the number of tall buildings in Chinese cities by more than half. Landscapes are changing in a matter of days. One of the more hypnotic items on YouTube is a time-lapse video of a 15-storey prefabricated hotel in Changsha being put up in just six days. "The range of outcomes in London and New York is pretty limited," says one investor. "In Shenzhen you can be building a block of apartments with four others going up alongside."

One way to manage the risk of oversupply is to take capital out of emerging markets as quickly as possible. ING's real-estate asset-management arm (soon to be part of CBRE) works with local firms to build flats and homes for sale in markets such as China, enabling it to realise profits in two or three years. Another is to go for the less crowded parts of the market. Mr White of CBRE thinks that the logistics sector is one of the more promising avenues for foreign investors, in part because the market is dominated by a handful of global firms based in America. Shopping centres are another area where foreigners still have an edge over locals.

But many investors who have raised funds for deployment in emerging markets will have trouble finding a home for their money. One reason is that these markets are thin: there is very little buying and selling of existing properties. Another is competition from locals. Mainland Chinese developers are wildly optimistic because they have seen values rise, says David Ellis of Mayer Brown JSM, a law firm. "They are using a different spreadsheet."

All this helps explain why many people are nervous about the state of the Chinese property market in general, and the residential part of it in particular. High-profile hedge-fund managers such as Jim Chanos give warning (self-servingly) of a property crash even worse than Dubai's. In January three of the ten biggest short positions in Hong Kong-listed mainland companies were held in property firms. Nationally, incomes in China have largely kept pace with rising prices (see chart 7), but an IMF report in December said that in some big cities prices "appear to be increasingly disconnected from fundamentals".

Rationing the air supply

The Chinese government has unveiled a series of measures since April 2010 to mute house-price inflation. They include raising the minimum downpayment for first-time buyers to 30% of a home's value, up from 20% before, and a stop on mortgages for people buying a third or subsequent home. These measures have had some success. The year-on-year price rise has slowed down: in December it was 6.4%, not that much higher than the overall inflation rate.

Even so, the market continues to look extremely buoyant on many measures. Total property loans outstanding last year rose by 27.5%, which at least was slower than in 2009. Policymakers lean towards further tightening. A property tax was announced in Shanghai and Chongqing at the start of this year, causing a rush to seal deals before it takes effect. Transactions in Shanghai in the first half of January reportedly jumped by more than a third year-on-year, according to local estate agents. Wen Jiabao, China's prime minister, has said he wants to see the residential market return to a "reasonable level" before his term of office ends in 2013.

As well as dampening down demand, the Chinese have been trying to increase supply. That may seem counterintuitive in a country with a home-ownership rate of about 80%. But that startlingly high rate was the result of a huge, one-off transfer of government housing to private ownership in the late 1990s. Much of it is dilapidated and most people want to move out and up. "There is pent-up demand that has been building for 50 years," says Michael Klibaner of JLL in Shanghai.

The problem for the average buyer is that prices have been driven higher not just by other would-be homeowners but by a complex chain of speculative activities that reaches right back to another arm of China's government, the local authorities. Land sales are a big source of revenue for local governments, and by drafting development plans for the land the government can hike its value several times over.

Until recently, local governments would sell this land to developers for very little upfront. A firm could buy land worth 5 billion yuan with just 500m yuan ($75.9m) in working capital, says Jinsong Du of Credit Suisse. Even better, the developer could then offer that land as collateral for a loan of, say, 2.5 billion yuan from a bank. And instead of ploughing those borrowed billions into developing the site, they could use it to buy more land. Developers were not too worried about generating cash flow, because in a pinch they assumed they could always sell the land at a profit or flog as-yet-unbuilt flats to eager buyers on the back of blueprints alone.

The viability of this model depends on ever-growing demand, which often comes from speculative investors looking for a chance of quick capital gains. Some are wealthy private individuals; many are enterprises that have been diverting money from capital investment, hoping for juicier returns from property.

All of this is a big headache for the central government, which is aiming to keep property affordable for the masses. A huge social-housing programme will eventually bring lots of cheaper housing on stream. In the meantime the government is trying to draw the air out of the speculative part of the market (by restricting mortgages taken out for investment purposes, and by banning many state-owned enterprises from buying land) and to put developers under pressure to build and release properties quickly. Banks now have to put money into an escrow account instead of lending directly to developers. The cash is paid out when construction reaches certain milestones. Downpayments from developers to local governments have shot up, too, and now total 60-70% of the land's value. That stretches developers' balance-sheets, encouraging them to drop prices.

Carpeted landing

The slowdown in property-price rises suggests that these policies are having some effect. But the upward pressure is still immense. To get round the new rules, some mainland developers are reportedly borrowing money offshore and dressing it up as equity when it comes onshore. The restrictions are not always properly implemented, particularly in smaller cities. A 2009 law allowed mainland insurers to invest another wall of money in property for the first time. Individual savers keep an enormous amount of cash in low-yielding bank deposits and have relatively few investment options, which increases the appeal of property-as does rising inflation.

Nonetheless, in two critical respects, comparisons between China and places such as Dubai are misplaced. One is underlying growth in demand. Some places in China may well be getting ahead of themselves: for example, it is not clear whether so many industrial cities really need a brand new central business district. If prices were to turn, the amount of vacant property being held as investment would make a wave of forced selling more likely. But China, with urbanisation and income growth on a massive scale, is clearly different from Dubai's model of "build it and they will come."

There are better parallels in the Middle East. Emile Habib of GulfRelated, a property-development joint venture in the region, says Dubai is saturated and the best prospects are places with lots of internal demand like Saudi Arabia.

The second difference is the amount of leverage in the system. The IMF reckons that loans to developers and mortgages accounted for under 20% of total outstanding loans in late 2009, compared with 52% in Hong Kong and 57% in America. Again, nobody should draw too much comfort from this. In a cash-driven market, liquidity can flow out of the sector quickly; mortgage debt is rising fast from a low base; and a property bust could spill over into other fields to which banks have lots of exposure. But as Western policymakers would now wearily agree, less debt means less systemic risk for the banks if and when the property cycle turns.

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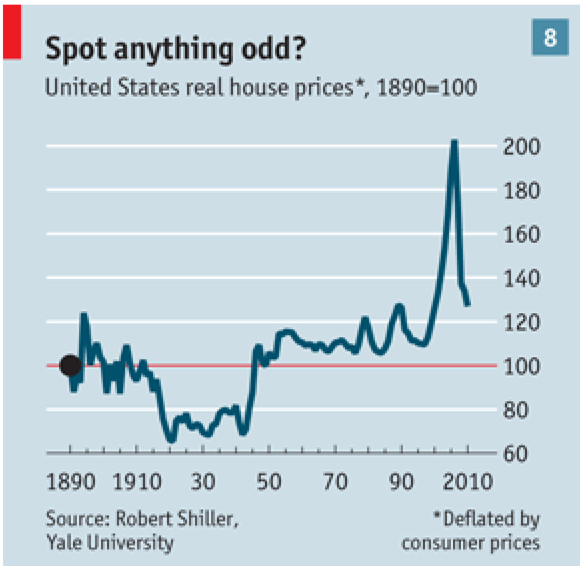
Between a rock and a living space

The lessons from the property boom



IF THERE is one chart that captures the madness of the housing bubble in the first half of the 2000s, it is Robert Shiller's index of real (ie, inflation-adjusted) house prices in America. The index goes back to 1890, and for the first 100 years or so prices go up and down but gain very little overall. Then, starting in the late 1990s, house prices pretty much double in real terms within a decade (see chart 8). The run-up in values was not just unprecedented, it was obviously lunatic. That begs an equally obvious question: if no one intervened to pop that bubble, is anyone likely to do so next time round?

Some argue that the market has learned its lesson, although even the bankers do not sound all that convinced. The crisis has clearly prompted changes to risk management and underwriting practices: more emphasis on affordability, more rigorous stress-testing, better pricing for borrowers with more equity to put in. The data from this debacle will inform the models of the future. Mr Jennings of FICO, for instance, says he is working on ways to relate customers' credit scores to the macroeconomic environment so that lenders can judge how the odds of default change when, say, unemployment goes up or down.

But for the reasons explained earlier in this report, property exerts a siren-like attraction for banks. Property loans are relatively light on capital and backed by real assets. In retail banking mortgages are thought to anchor long-term relationships with customers. Lending on commercial property is lumpy enough for a single big deal to get sales teams to their targets. To keep it under control, HSBC imposes a global 12.5% cap on commercial-property assets as a proportion of its overall book.

Prophets scorned

The crisis has made it obvious that when things get frothy, banks find it difficult to hold back. Property valuers in Dubai who advised banks that the market was overheating were ignored. Regulators in Britain and America who issued similar warnings were disregarded. Whistleblowers inside banks fared little better. An ex-employee of Countrywide, a particularly gung-ho American lender, recalls presenting a forecast of a flat housing market to a meeting at the bank in 2006 and being shouted down by salespeople, who argued that if they priced for credit risk on that basis they would be out of business.

Taking a break

If the market cannot be trusted to ease up on property when it overheats, that leaves policymakers. Very broadly, there are three levers that officials can pull to make property safer. All three of them need to be used.

The first is the institutional framework that is controlled by governments-things like tax breaks, housing subsidies, land supply and the laws on recourse in the event of default. Some of these are more tractable than others; for example, the case for a property tax is theoretically powerful, but no one wants to do anything that might subdue housing markets while they remain weak. Nonetheless, fiscal pressures may require governments to introduce big changes. Under draft proposals for pruning America's budget deficit, mortgage interest will enjoy fewer tax advantages.

The second lever is the system of mortgage financing. Disentangling the various causes of the property bubble is extremely difficult, but few would dispute that easy credit played a part in driving up prices and making the bust worse. According to a recent OECD report on housing and the economic recovery, financial deregulation may have boosted real house prices across industrial countries between 1980 and 2005 by as much as 30%. More liberal financing regimes are often a good thing (ask any young Italian who wants to buy a home), but only as long as basic underwriting standards continue to be met.

The crisis has set off a search for the best possible mortgage-financing system. Many observers warmly commend the Danish model, which features specialised mortgage lenders that observe strict loan-to-value limits, along with a system of matched funding in which each mortgage is financed by a specific bond with the same maturity and cash-flow characteristics. Losses at Danish mortgage banks remained low and there was plenty of liquidity throughout the crisis.

The Danish system, like the American one, also protects borrowers from interest-rate risk by offering long-term fixed-rate mortgages (although adjustable-rate mortgages were spreading fast before the crisis). That has undoubted appeal for policymakers in countries where floating-rate mortgages expose borrowers to the risk of payment shocks as rates rise.

Inimitable Copenhagen

In truth, however, there is no magic system. The Danish mortgage banks are clearly too big to fail, so the problem of an implicit government guarantee for banks remains. The same is true for Canada, where those who want to borrow more than 80% of the value of a property have to pay an insurance premium to a government agency. And even if the perfect model existed, it might not be transferable. The specialised infrastructure of the Danish mortgage-bond market, for instance, could not be easily replicated elsewhere.

And as so often in finance, constraining liquidity in one part of the system risks shifting trouble somewhere else. Danish banks had problems with commercial property. Spain's residential-mortgage standards were fine, but the same could not be said of banks' lending to developers. German banks that were not able to go mad on mortgages at home bought up American subprime loans instead.

Imposing rigid limits on how much people can borrow either disenfranchises some-first-time buyers and the self-employed tend to suffer most-or risks encouraging them to find a way around the rules by topping up their borrowing with

more expensive, unsecured financing. Some lenders also fret that if underwriting becomes too prescriptive, borrowers are relieved of taking responsibility for their own actions. These are legitimate worries, but they carry alarming echoes of arguments put forward by bankers at the height of the housing boom just gone.

The third lever that policymakers can pull is the now-popular idea of leaning against the wind when systemic risks are rising. Such "macroprudential" regulation is already common in some parts of the world. Governments and regulators in China, Hong Kong, Singapore and elsewhere always seem to be adjusting loan-to-value ratios, restricting the availability of credit for speculative homebuying, imposing taxes on homes that are flipped within a certain period and so on.

Macroprudential regulation is a good idea in theory, but extremely hard to do well. First, there is the difficulty of spotting bubbles, which often look unsustainable only when they have already burst. Despite the evidence of Mr Shiller's chart, lots of clever people in finance and in the corridors of power persuaded themselves that things were different this time. And once property booms have got going, they can be hard to calm down, as China's authorities have found. Still, the politics of dampening booms is easier in emerging markets, where there are usually more people to help into homes than there are existing homeowners. "Macroprudential regulation is not seen as an intervention," says one Asian central banker. "It is seen as part of a healthy credit relationship."

Regulators and central banks in developed economies are feeling much more nervous about the prospect of cooling property markets. "We know that punchbowl-removal operations are very unpopular among the slightly sloshed," is how one Western regulator puts it. The sloshed can include governments themselves. Thanks to transaction taxes, property bubbles are helpful to exchequers and the jobs market when they first get going. Regulators will therefore need to have a very clear mandate, or use automatic measures such as a countercyclical loan-to-value rule, to resist the pressures they will face when the next boom is under way.

This mortar coil

That problem is years away; but in America the worst effects of the property crisis are probably over. The banks with the biggest exposures to dud commercial assets are smaller lenders, and the government is willing to provide support to residential markets. But prices are likely to keep falling this year, so economic recovery will lack one of its usual booster rockets.

Parts of Europe are much more fragile. Prices still have further to fall to reach fair value, the capacity of certain banks and governments to cope with losses is more doubtful, and the risk of interest-rate rises looms. Even if the sense of crisis fades, the chronic effects will linger for years as property weighs down banks' balance-sheets, first-time buyers struggle to get on the housing ladder and buildings in second-rate locations slowly decay.

Property may be prone to excess everywhere but the policy response to the events of the past decade will-and should-vary from country to country. Culture, taxes, politics, demography, laws and physical geography all have an influence on property markets. Americans like to own their homes. The Hong Kong government has a limited supply of land. The Danes understand, as few others do, that the market value of their debt can shift.

But if there is one universal lesson from the recent past, it is that leverage is lethal. Upping the amount of equity that banks have to hold is one way of keeping down the amount of debt that finds its way into property, but this is still an asset class that is privileged, not imprisoned, by the capital regime. As one Asian regulator points out, even highly capitalised banks like lending against homes. The best way to limit the damage from a property bust is to exercise more direct control over the amount of debt available to property owners and developers, whether through discretionary interventions or standing rules.

The past decade has proved again that the phrase "safe as houses" is a nonsense. Property will always be volatile-and financial crises will always be destructive. The main aim for policymakers must be to sever the connection between the two.

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A special report on property

Sources and acknowledgments

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Aerospace in Israel

IAI takes wing

Israel's biggest defence firm is getting ready for privatisation

HIS career since leaving the air force has been in business rather than politics, but Yair Shamir, the chairman of Israel Aerospace Industries (IAI), is a chip off the old block. Not only is he a dead ringer for his famous father-Yitzhak Shamir,

an uncompromising Israeli prime minister in the 1980s and early 1990s-he is a similarly tough operator. When Mr Shamir, an important figure in Israel's booming high-technology business, took on the job of sorting out his country's biggest industrial company in 2005, state-owned IAI was in a wretched condition.

For one thing, it had never quite got over the blow to its self-confidence when the Lavi, an advanced dual-role combat aircraft, was cancelled by the government headed by Mr Shamir senior in 1987. Although the Lavi was on course to meet all its performance targets, the cost of the project and American concern that it was helping to finance a rival to its F-16 and F-18 fighters killed it. For IAI, it meant that it would never again try to make a fast jet on its own.

For another, despite recovering much of its technological elan, IAI was an organisational and financial mess. Executives say it had gone three years without a formal chairman and two years without a signed financial statement. Banks had seized some of its financial assets and its chief executive of 20 years, Moshe Keret, was facing bribery allegations (he denied these and the case was dropped for lack of evidence). The firm was also in the grip of the Histadrut union federation, which fought all attempts to slim a bloated workforce and introduce merit-based remuneration.

When Mr Shamir arrived on the scene he was fresh from helping guide the national flag carrier, El Al, towards privatisation and he was willing to take on the job only if he had the same freedom to lead IAI in a similar direction. Fortunately, although much needed to be done to create what Mr Shamir calls a culture of transparency and accountability, the basis of a powerful business was there. Part of IAI's purpose has always been to provide the Israel Defence Forces (IDF) with the means to maintain the country's security against its many enemies. But to achieve reasonable scale despite a relatively small national defence budget, and to compete with rivals many times its size, IAI has been obliged to chase foreign sales. Today, says Mr Shamir, around 80% of IAI's revenues are earned abroad, with Asia the firm's fastest-growing and biggest market.

The company's close links with the IDF help in several ways. "As used by the IDF" is a big selling-point, says Mr Shamir. The IDF's experience of fighting frequent wars has meant that IAI has a demanding primary customer that is always trying to keep several moves ahead of its potential foes. For example, since the mistakes made both before and during the Yom Kippur war of 1973 the IDF has put a premium on real-time intelligence to give it "situational awareness". After the cancellation of the Lavi, IAI concentrated more on developing unmanned aerial vehicles (UAVs, also called drones) and satellites to provide first the IDF and then overseas customers with state-of-the-art capability in intelligence, surveillance and reconnaissance.

IAI now offers a range of observational and communications satellites that combine the same performance as rival systems with very light weight, which makes them both cheaper to launch and more agile in orbit. Its fleet of UAVs extends from tiny electric-powered "kites" that let infantry peer over the next hill, to the Eitan (pictured), a pilotless aircraft with the wingspan of a Boeing 737 that can stay aloft for 35 hours at more than 40,000 feet and is said to be capable of reaching Iran. The Eitan is able to perform a mix of missions from surveillance to jamming enemy communications and is clearly more than big enough to carry ground-attack missiles. A smaller version of the Eitan, the Heron, is in service with nine air forces and is being used extensively in Afghanistan. IAI has also developed a manned airborne early-warning system based on a Gulfstream G550 executive jet.

Another area where IAI is uniquely strong because of Israel's security requirements is in anti-ballistic-missile defences. Its Arrow 2 interceptor missile (developed with Boeing) will soon be joined by the Arrow 3 to form part of a four-tier territorial and theatre defence against every kind of rocket attack. No other country has yet bought the Arrow, although India and Turkey have both expressed interest.

As well as its thriving defence activities, IAI also manufactures a mid-size business jet for Gulfstream and carries out cargo conversions of commercial airliners, a business that suffered during the downturn but which is now picking up. Group sales in 2010 should exceed $3 billion and Mr Shamir reckons that in two years' time they will be more than $4 billion. Net profit for the first nine months of 2010 was $80m compared with $53m in the same period a year before. In 2009 IAI paid a dividend to the Israeli government of $90m.

Quite when privatisation will come remains uncertain (there is still some resistance within the defence ministry as well as from the union), but for Mr Shamir it cannot happen soon enough. Privatisation will give IAI currency and flexibility for acquisitions and allow it more discretion over how it spends its R&D cash. Mr Shamir's vision is to float 30% of the company in an initial public offering and to give 10% in stock options to employees. Over five years he expects the government's share to fall to 49%. He would like to see IAI dual-listed on an international stock exchange, such as NASDAQ, as well as the local TASE. Given its strategic importance to Israel, IAI may never be quite a normal company. Mr Shamir, however, would happily settle for normal enough.

Diageo's deals

Replenishing the drinks cabinet

Raki with a bourbon chaser?

EVER since Diageo was created 13 years ago through the mega-merger of two British drinks giants, Guinness and Grand Metropolitan, it has steered clear of big takeovers. The world's biggest maker of alcoholic drinks sold Burger King, Haagen-Dazs, Pillsbury and other food companies unrelated to its core business. It focused on Johnnie Walker, Smirnoff, and Guinness, its flagship global brands in whisky, vodka and stout.

Now things seem to be changing, as Diageo dips into a war chest of several billion pounds that it has accumulated in recent years. On February 21st the company announced the takeover of Mey Icki, Turkey's largest maker of raki, an aniseed drink. It is paying pound1.3 billion ($2.1 billion), a rich price; but analysts say it is justified because of Mey Icki's high operating margins and its first-rate distribution network in a big, thirsty emerging market.

After the deal in Turkey is completed, more than 35% of Diageo's revenues will come from emerging markets. The group has a strong presence in Africa thanks to Guinness, and in Latin America mainly thanks to Johnnie Walker and Buchanan's, another Scotch whisky, as well as Red Stripe, a Jamaican lager. The company's boss, Paul Walsh, predicts that in four to five years he will have raised the emerging markets' revenue share above 50%.

This continued growth is likely to come to some extent through the takeover of local booze brands in India, China and Brazil. But most of it will be created by selling traditional European and American brands to the developing world's growing middle classes. The biggest potential takeover targets likely to be in Diageo's sights are American and French.

The most desirable fish will also be the trickiest to catch. Diageo already owns 34% of Moet Hennessy, a maker of fine champagnes (Moet & Chandon, Krug and Dom Perignon) and cognac (Hennessy), and it would like to buy the remainder of the business, which is owned by Moet Hennessy Louis Vuitton (LVMH), a luxury conglomerate. Such a deal would close the cognac and champagne gap in Diageo's otherwise well-stocked drinks cabinet, and would help its expansion in China. Moet Hennessy has 47% of the market for cognac, and well-off Chinese have quite a taste for the stuff.

The trouble is that Bernard Arnault, the boss of LVMH, says he does not intend to sell his drinks business. He has enough cash to continue pursuing deals in LVMH's high-fashion and accessories businesses-unless, that is, he suddenly makes progress in his quest to take complete ownership of Hermes, a luxury-goods business, which the Hermes family is fighting tooth and manicured nail.

In the shorter term, Pablo Zuanic at Liberum Capital, a stockbroker, expects Diageo to buy a stake of up to 70% in the spirits business of Fortune Brands, an American conglomerate, for pound3.5 billion-4 billion. Jim Beam, Fortune's biggest spirits brand (others include Maker's Mark and Old Crow), would allow Diageo to compete more effectively with Brown-Forman, the owner of Jack Daniels, in the lucrative market for bourbon, an American style of whisky.

Unfortunately for Diageo it is barred from buying Fortune's tequila and cognac brands because of its agreement with Cuervo of Mexico to distribute that company's Jose Cuervo tequila, and its understanding with Moet Hennessy to stay away from other cognac and champagne brands. It will probably have to stay clear of Fortune's vodka brands too, because of antitrust concerns.

Instead of the complicated deal with Fortune Brands, Diageo could simply try to buy Jack Daniels, whose sales volumes and selling price are higher than Jim Beam's in America. But the family-owned Brown-Forman is not for sale. The only thing that might make the Brown family members sell the firm is if Diageo did take control of Jim Beam and became a mighty rival in the American spirits market.

If so, the buyer could be Pernod Ricard. After its takeovers of Britain's Allied Domecq and Vin & Spirit, a Swedish drinks maker, Diageo's closest rival (see chart) is too indebted to make a big acquisition now. But if Brown-Forman were for sale in a few years it might by then have paid down enough debt to make a bid.

America already accounts for 40% of Diageo's revenue so it seems odd for it to make a big bet on a mature market when all eyes are on emerging economies. Yet whereas Europe's beer and spirits markets are in the doldrums, per-capita consumption of spirits in America is increasing, especially among young consumers. Jason DeRise, a beverage analyst at UBS, notes a theory that "you don't drink what your father drinks", and says that whereas oldies are still content just to chug beer, younger adults seem to be trying out the hard liquor that grandpa used to knock back.

Diageo's beer business has been struggling recently, especially in crisis-hit countries such as Ireland, Guinness's spiritual home. It could sell this to raise the cash to buy Fortune Brands or the rest of Moet Hennessy, but Mr Walsh is adamant that he will not do so. Guinness has survived many ups and downs in the 250 years it has been brewed, and Diageo's boss is confident that its recent sales slump in Europe will be a mere hiccup.

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Japanese electronics firms

The mighty, fallen

Ex-world-beaters swallow their pride and do deals with foreign rivals

JAPAN'S electronics companies once epitomised its national power and defined late-20th-century consumer technology. Sony introduced the transistor radio and the Walkman. Toshiba was first to mass-produce laptops. Sharp-which got its name from inventing the mechanical pencil in 1915-pioneered solar cells and LCD screens. The companies earned their fortunes from running efficient operations at home that shipped in huge quantities to the West.

But the world changed and Japanese technology firms did not keep up. They kept too many low-value activities in high-cost Japan for too long. They focused on satisfying domestic consumers with advanced features that didn't matter to customers elsewhere. And they were tardy in entering emerging markets. Over the past decade NEC and Hitachi posted returns on assets of around 2%. In an extraordinary reversal, last year Japan became a net importer of televisions and stereos (albeit often with a Japanese brand on the casing).

In recent months the electronics companies have begun to overhaul their businesses by outsourcing operations and selling poorly performing units. And as they do so, they are striking alliances with Asian rivals that they once would have regarded as inferiors.

The biggest changes are taking place at NEC, which is also the most ailing. On February 25th it agreed to sell 70% of its LCD-panel production business to AVIC, a Chinese company. A few weeks earlier NEC had partially exited the personal-computer business by creating a joint venture with Lenovo, a big Chinese computer maker. The deal is an implicit admission of failure: NEC is the top PC maker in Japan, with a 20% market share, but globally its share is less than 1%. It comes six years after IBM sold its PC division to Lenovo, and NEC's delay means it was stung with more losses and got less for the business.

Toshiba said in December that it would outsource production of some logic chips. Samsung of South Korea will get some of the work. Toshiba's decision to collaborate with a company with which it competes fiercely in flash memory, among other things, is remarkable.

Taiwan's Hon Hai (also known as Foxconn), the world's biggest outsourced manufacturer, is moving in. Last year Sony sold control of its television factories in Mexico and Slovakia to Hon Hai and transferred production to it; half of the televisions it sells are now assembled by other firms under its "asset-light" strategy, compared with just 20% a year ago. Hon Hai is also said to be talking to Sharp about outsourcing some LCD-panel production; and to Hitachi Display, which makes small LCD screens for mobile phones, about buying a controlling stake.

This flurry of deals shows how Taiwanese, South Korean and Chinese firms have caught up with Japanese ones. It also shows how the Japanese have realised that such foreign firms can be useful partners as well as deadly rivals. The deals let the Japanese firms exit capital-intensive, low-margin businesses in which scale is needed but the product is little differentiated. This frees them to focus on becoming premium-brand marketers of products, and providers of services allied to them, as well as on developing the next generation of gadgets-or that is their hope.

Japanese electronics firms remain powerhouses of innovation. Last month, as NEC announced its foreign tie-ups, the company also trumpeted the world's thinnest mobile phone (at 7.7 millimetres) and the first contactless fingerprint and finger-vein reader for biometric authentication. NEC in particular still has a long way to go in turning itself around, but the Japanese firms' technological strengths mean they should not be counted out yet.

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Tablet computers

The second coming

Apple's revamped iPad will be hard for its competitors to beat

Keep taking the tablets

WHEN the iPad was launched last year, it was dubbed "the Jesus tablet" because of the quasi-religious fervour with which it was greeted by consumers worldwide, who have since snapped up more than 15m of them. Now Apple wants to create even more converts. On March 2nd Steve Jobs, its boss, returned briefly from sick leave to introduce the iPad 2, a revamped version that will compete with a host of rivals now coming to market.

Among these are devices such as Motorola's Xoom that are based on a new version of Google's Android operating system designed specifically for tablets. Android-based smartphones have rapidly eroded the market share of Apple's popular iPhone. But when it comes to tablets, the iPad's lead should prove more durable.

For a start, Apple has had the tablet field to itself for a year, allowing it to refine its offering and raise the bar for rivals. The iPad 2 is considerably thinner, lighter and faster than its predecessor and offers videoconferencing and other capabilities whose absence in the first iPad was widely criticised.

Another reason to bet Apple will maintain its lead is that rivals with similar capabilities have turned out to be more expensive, whereas the new iPad, despite its extra features, will cost the same as the old one. In America the Xoom costs $800 without a wireless contract and $600 with a two-year one from Verizon. The cheapest iPad 2 is $499 without a contract. Sarah Rotman Epps of Forrester, a research firm, reckons high prices will prove fatal for these rivals. Apple has other advantages, such as an online store full of software programmes, or apps, designed for iPads, as well as content that can be downloaded to them.

Yet the closed nature of such stores also makes some people hesitate to buy tablets. In a recent survey by the Boston Consulting Group (BCG), more than 80% of American respondents said being able to access content from anywhere would be an important factor in their choice of e-reader or tablet. John Rose of BCG reckons Apple's iTunes music store succeeded because it had to strike deals with only the handful of firms that dominate the record business; it will be far harder to reach exclusive agreements with the diverse owners of the many other types of content tablet users might buy.

That is unlikely to stop Apple from trying, though. Mr Jobs is a notorious control freak. He is also a tech visionary whose notion of tablet computing has delivered yet another smash hit for Apple. The father of the Jesus tablet is no doubt already planning his next miracle.

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Sports-surfaces makers

Ready, set, grow

How an Italian firm wins in the Olympics

Usain Bolt appreciates a good running-track

FASTER, higher, farther: such are the hopes of Mondo, a sports-equipment maker, for athletes at the 2012 London Olympic games. Engineers, chemists and biomechanics scientists at the firm, the games' supplier of running track and surfaces for ten other sports, have developed materials to help the athletes perform their best. After visiting Mondo's factory in a village south of Turin on February 23rd, officials from London gave their approval for the brick-red strips of rubber composite that the firm will soon begin installing.

Set up in 1948, the year that London last hosted the Olympics, Mondo progressed from making rubber balls for a local fist-ball game to making floors for hospitals, gyms and trains. Then Ferruccio Stroppiana, its founder, and his brother Elio realised they could make much higher-quality surfaces by prefabricating them rather than spreading the materials on-site.

The firm installed its first prefabricated running track in Italy in 1972 and four years later did training tracks for the Montreal Olympics. It then had 200 workers. Now it employs 1,500 and has factories in Canada, Spain, China and Luxembourg as well as Italy. It lays around 150 tracks a year, with sales last year of euro340m ($469m). "We're profitable but too many Olympics would put us out of business," jests Maurizio Stroppiana, the general manager. Winning a contract to supply the games does little for profits-London's Olympics will generate only around euro6m of revenues-but is good marketing.

How did a family firm in a rural area best known for producing fine wines like Barolo become a world-beater? The Stroppiana brothers' intuition that prefabrication would produce better tracks was the starting-point. Since then Mondo has invested heavily in research and development, on which it spends about 5% of revenues and employs 40 people. At the heart of the work are the dynamics of running: how athletes place their feet; what forces are involved; and how surfaces respond in terms of grip, friction, elasticity, energy return and shock absorption. Mondo protects its intellectual property with more than 200 patents. The Olympic authorities are keen on technological advances, and anything that helps runners break records will add to the excitement for spectators.

In London, as in previous Olympics, the firm will be responsible for maintaining as well as installing the tracks, crucial services which help it fend off competition. Besides Polytan, a longstanding German rival, Chinese firms have entered the fray using technology that, according to Mr Stroppiana, copies Mondo's. They are fighting over markets that are declining in Europe and static in North America, regions where installations of new tracks together amount to about 800 a year. Only emerging economies offer growth.

Four world track records were broken in the Beijing games in 2008. Mr Stroppiana notes that new records are mainly down to the athletes' training, their performance on the day, the weather and encouragement from spectators. But he can be sure that if records do not fall in London, some people will blame the track.

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Asia's talent market

Locals first

Employment in Asian firms is booming-but for locals, not Western expats

BACK in the days when cushy jobs for foreigners were plentiful in Asia, Western expats used to get called FILTH-"failed in London, trying Hong Kong". Now, though, they may end up as FISHTAILS-"failed in Shanghai, trying again in London". This is because employers in Asia, despite strong demand for managers and professionals, increasingly choose to hire locals, not outsiders.

Overall, the jobs outlook is brighter the farther east you go: the latest survey by Manpower, an employment consultancy, found that companies in India, China and Taiwan expect to hire more than firms in other countries during the first half of 2011. Western companies in all sorts of industries are continuing to push into Asia's high-growth economies. This week, for example, Tesco, Britain's largest retailer, announced a big expansion in China.

However, Joe Expat may not get much of a look-in. Graduates are flooding on to Asia's job market from local universities, and Asians with degrees from Western ones are returning home. Since 2003 roughly 325,000 Chinese have returned after studying overseas-more than three times as many as in the entire two decades before-according to David Zweig of Hong Kong University of Science and Technology, who is writing a book on the subject. The number of Chinese studying abroad and expected to return home afterwards continues to rise. Even Westerners with top-class MBAs are finding it tough. Andrew Stephen of the Singapore campus of INSEAD, a prestigious French business school, says he has seen good candidates being passed over by multinationals because they were not Asian.

Since there is no longer so much need for foreign workers, Asian governments are tightening their visa rules. In 2008 Singapore granted 156,900 work visas to foreigners and less than half that number of jobs went to residents. Now the numbers are roughly equal. "There isn't an overwhelming need to import young and enthusiastic people any more," says Declan O'Sullivan, a director of Singapore-based Kerry Consulting.

It is not just a question of supply and demand, though. Big employers in Asia, especially those that have got burned in their past dealings with local governments, are putting a premium on local knowledge, language and connections. Recruiters say candidates with a demonstrable long-term commitment to a country, and ready-made *guanxi* (business and political relationships), get preference. The locals-first attitude to hiring extends up all the way to the most senior executive levels. Just as experience in Asia is coming to be seen as an essential career step in Western multinationals, the opportunities for recent graduates to gain such experience seem to be shrinking.

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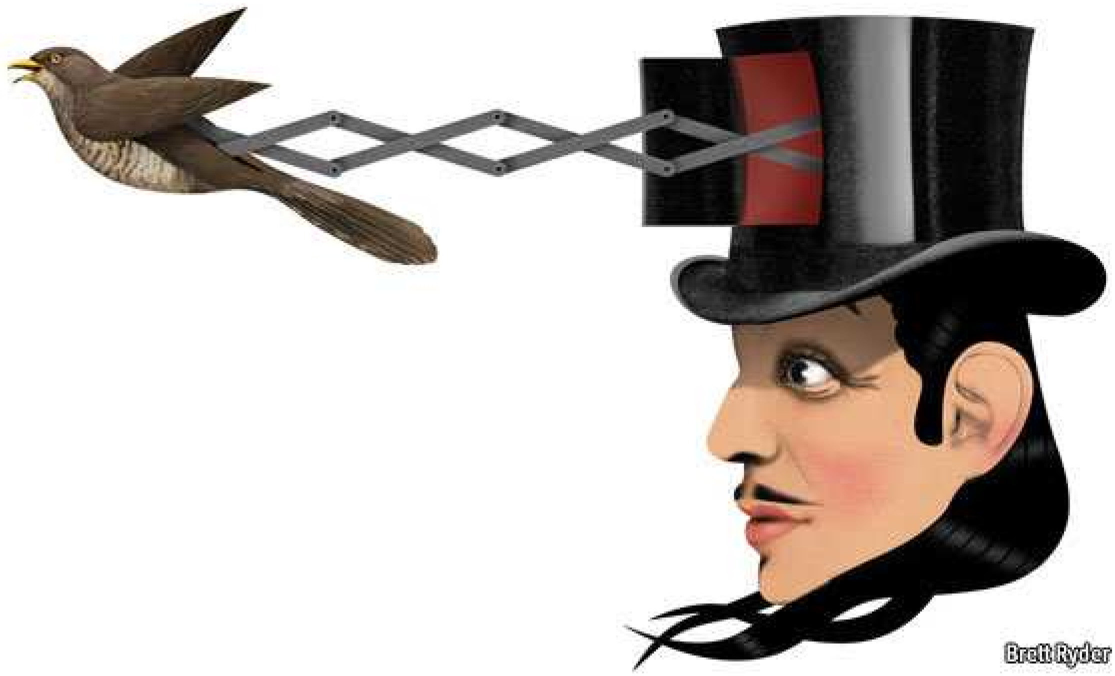
Schumpeter

When stars go cuckoo

What John Galliano's fall tells us about the perils of relying on creative geniuses



ON FEBRUARY 24th John Galliano, Christian Dior's star designer, launched an anti-Semitic rant in a Paris bar, Le Perle-or so it is alleged. Mr Galliano denies the offence and there are no independent witnesses. But a few days later a video surfaced of Mr Galliano engaged in similar behaviour. "I love Hitler," he told an unidentified group. "Your mothers, your forefathers, would all be fucking gassed." Christian Dior first suspended him and then, as outrage over the video grew, sacked him.

Mr Galliano shared the headlines with another exploding star, Charlie Sheen. While holidaying with a couple of girlfriends-one of whom is a professional porn star-Mr Sheen decided to tell a radio show what he thinks of his producer, Chuck Lorre: a "charlatan" and a "turd" (he denied any anti-Semitic intent in referring to Mr Lorre by the Hebrew version of his name, Chaim). CBS and Warner Brothers pulled the plug on Mr Sheen's hit television comedy, "Two and a Half Men", for which he was being paid a reported $1.2m an episode.

These two incidents have inevitably been compared to an even bigger explosion. For years Mel Gibson was one of the most feted stars in Hollywood-the sexiest man alive according to *People* magazine and the hottest celebrity in the world according to *Forbes*. But Hollywood's love affair with Mr Gibson ended abruptly on the Pacific Coast Highway in 2006. Mr Gibson told a traffic cop that "the Jews are responsible for all the wars in the world" before asking "are you a Jew?" He also added a bit of sexism to his racism by calling a female police officer "sugar tits".

Why do people who live such enviable lives-being paid millions to do what they love-act so outrageously? Drink and drugs clearly play an important part. The video of Mr Galliano's rant suggests that he was sozzled. Mr Sheen has been in and out of rehab. Mr Gibson had an open bottle of tequila next to him on the seat of his car. Alexander McQueen, another British maverick who made it big in the Parisian fashion world before committing suicide, also had a long history of drink and drug problems. This is par for the course in the creative industries: the two best places for young people on the make in Hollywood to meet the players are bars and Alcoholics Anonymous meetings.

But celebrity can be an even more powerful drug than cocaine. It encourages people to push the limits: the more scandalous they are the more they attract the attention of the paparazzi. Mr Galliano produced ever more outrageous fashions as his fame grew. In 2000 he dressed his models like tramps-*le look clochard*-with newsprint dresses and dangling pots and pans. He probably counted the fact that protesters surrounded Dior's offices as a publicity triumph. Celebrity also makes people think they are fireproof: their fans love them come what may. Mr Sheen seems to have revelled in his bad-boy image. But there is clearly a line that you cross at your peril: insulting your boss in Mr Sheen's case or endorsing the Holocaust in Mr Galliano's.

How should creative companies deal with stars' bizarre behaviour? Sometimes the sins are so egregious that they have no choice but to drop them. Christian Dior is busy congratulating itself on taking a stand on Mr Galliano. But in fact it was a simple commercial decision. Mr Galliano is undoubtedly a talented designer who sprinkled Dior's once dowdy fashion house with pixie-dust. But he was nevertheless a small part of the empire: Mr Galliano's couture accounted for only 4% of Dior's euro21 billion ($29 billion) in sales in 2010. Mr Galliano also alienated some of Dior's other big names: Natalie Portman, an Oscar-winning (and Jewish) actress who advertises a Dior perfume, made it clear that she would not be associated with Mr Galliano in any way.

But in most cases they are much more lenient. Creative industries are driven by their stars. They also feed on the buzz that bad behaviour generates. Warner and CBS forgave Mr Sheen a succession of misdemeanours-including assault on his third wife-because he was the star of one of its most successful shows: without him there would be no "Two and a Half Men". Mr Sheen's fatal error was to pit his brand against his producer's: Mr Lorre is credited with almost single-handedly reviving the traditional "four-camera sitcom"-a comedy that is cheap to make (Mr Sheen's enormous salary aside) and repeats well.

The growing risk of sticking with the talent

The business reason for sticking with "the talent" is that there is a long list of stars who have revived their careers after egregious gaffes. Eric Clapton survived a racist rant that he delivered in Birmingham in 1976. The Beatles suffered no long-term damage from John Lennon's declaration that they were "bigger than Jesus". Mr Gibson may be on the way back: a profile in the current *Vanity Fair*, "The Rude Warrior", is full of affectionate quotes from the likes of Whoopi Goldberg and Jodie Foster. Mr Sheen is not going without a fight: he has been a permanent guest on the chat shows since his "meltdown" and has become one of the most popular new arrivals on Twitter. Who wants to ditch an asset like this?

But new technology may be changing this calculation, both by making it easier to catch stars who act like idiots and by making it harder for companies to rehabilitate them: Mr Galliano's anti-Semitic rant will live for ever on YouTube.

Furthermore, great creative machines like Hollywood and the fashion industry have another reason to abandon assets who become liabilities: there is always more talent to replace them. The fashion industry is already debating whether Riccardo Tisci of Givenchy or Alber Elbaz of Lanvin, or Hedi Slimane, a former Dior man, would make the best successor to Mr Galliano. Mr Lorre no doubt can find other actors to speak his lines. Charles de Gaulle once said that the graveyards are full of indispensable men. The same can be said of the bars of Los Angeles and Paris.

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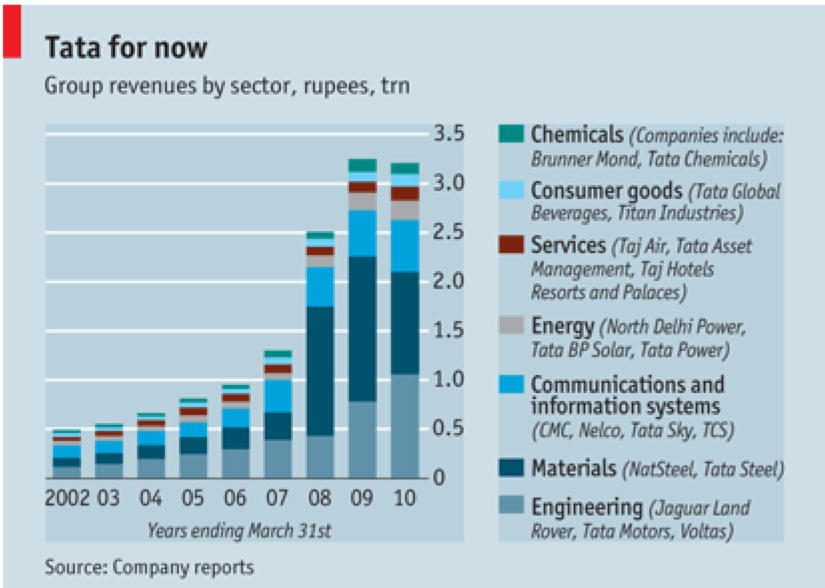
The Tata group

Out of India

Under Ratan Tata, the business group that bears his name has transformed itself from an Indian giant into a global powerhouse

RATAN TATA is as different as can be from the popular image of a business titan: he is a natural gentleman who lives austerely, litters his conversation with references to "dignity" and "duty" and is happiest when talking about his pet dogs, two German shepherds. He owns less than 1% of the group that bears his family name. But he is a titan nonetheless: the most powerful businessman in India and one of the most influential in the world.

The Tata group, of which he is chairman, is a giant too-or rather a collection of them. This family of companies covers cars and consulting, software and steel, tea and coffee, chemicals and hotels. Tata Consultancy Services (TCS) is Asia's largest software company. Tata Steel is India's largest steelmaker and number ten in the world. Taj Hotels Resorts and Palaces is India's biggest luxury hotel group by far. Tata Power is the country's largest private electricity company. Tata Global Beverages is the world's second-largest maker of branded tea. Overall, the group earned 3.2 trillion rupees, or $67.4 billion, in revenues in 2009-10 (see chart) and 82 billion rupees in profits.



Mr Tata has transformed the group. When he became chairman in 1991, India was groaning under the Licence Raj and Tata seldom ventured outside its home market. Today, as he prepares to step down in late 2012 and the search for a successor speeds up, India is one of the world's most dynamic economies and Tata operates in over 80 countries. The latest sign of its ambition came this week at the Geneva motor show, where Tata Motors showed a prototype of a small car for European drivers.

But the Tata story is about more than its own transformation. Just as Tata played a leading role in nation-building from its foundation in 1868, creating India's first Indian-owned steel plant, power station, luxury hotel, domestic airline and sundry other firsts, it is now one of the stars of India's globalisation. The group has also projected a new type of company onto the global stage-more diversified than Western firms, more engaged in the life of the community and, if its employees are to be believed, better equipped to prosper in both developed and developing markets.

The house that Ratan built

Mr Tata's enthronement in Bombay House, the group's headquarters, took place just before the liberalisation of India's economy, an event that Indian business people habitually call the country's "second independence". He spotted that liberalisation was both an opportunity and a threat. It was an opportunity because it set Tata free: the economy had been so tightly regulated that you could be fined or even imprisoned for exceeding your output quotas. It was a threat because Tata was vulnerable. Its companies were unco-ordinated, overmanned and undermanaged. They had competed with each other so vigorously that four textile mills drove each other out of business, yet there was a serious risk that leaner, fitter foreigners would wipe out the lot.

Mr Tata set about streamlining with a vengeance. He focused the group on six industries that have provided most of its revenues since 2000-steel, motor vehicles, power, telecoms, information technology (IT) and hotels-and increased its often paltry shareholding in these core businesses. He gradually established Bombay House's power over the barons who had ruled the various businesses for decades. Companies now have to earn the right to use the Tata brand. The Tata Management Training Centre does as its name says; and TAS selects high-flyers who move regularly from one company to another as their careers develop. Teams of "auditors", stars from across the group, conduct annual surveys of selected companies, reporting on progress and suggesting lessons to learn.

The group embraced globalisation. The pace of foreign acquisitions has grown dramatically: in 1995-2003 Tata companies made, on average, one purchase a year; in 2004 they made six; and in 2005-06 more than 20. So has the scale. Tata Tea's takeover of Tetley Group, a British company, for $450m in 2000 was the first of several bold buys of well-known brands that announced the group's arrival in the global big league. In 2007 Tata Steel bought Corus, Europe's second-largest steelmaker, for $12.1 billion. A year later Tata Motors paid $2.3 billion for Jaguar Land Rover (JLR).

In all Tata has spent around $20 billion on foreign companies. Today it earns about three-fifths of its revenue abroad and employs more British workers than any other manufacturer, and two of its biggest companies, Tata Motors and Tata Communications, are listed on the New York Stock Exchange.

Tata has been busy in emerging markets, too. Tata Steel and Tata Motors have been snapping up Asian companies, such as Thailand's Millennium Steel and South Korea's Daewoo trucks. At home Tata Motors makes the first Indian-designed car, the Indica, and the world's cheapest, the Nano. Mr Tata talks about the company's duty to produce groundbreaking products for the world's poor with missionary zeal.

The changes have been dramatic. A group that used to be identified with secure employment ("for shoes there's Bata and for jobs there's Tata") has become obsessed by serving its customers and matching international standards. Tata Steel has more than doubled its output since 1994 (from 3m tonnes to 6.4m) while cutting its workforce in India by more than half (from 78,000 to 30,000). A jaunty self-confidence has replaced the self-doubt of the early 1990s. Yet Mr Tata's changes have gone only so far. That is partly because of caution and reverence for tradition, but also because there is logic behind the group's diversity.

E pluribus plura

In Jamshedpur men in thick denim shirts and hard hats watch as molten steel is poured from a gigantic ladle. In Mumbai young women in exquisite saris add to the allure of the Taj Mahal Palace & Tower hotel. In Pune PhDs from the Massachusetts Institute of Technology and various Indian Institutes of Technology feed data into one of the world's most powerful privately owned supercomputers. They are all part of Tata's global workforce of about 395,000 people.

For all the frantic restructuring the group remains strikingly diversified by Western standards: 98 operating companies, 28 of them listed on the Bombay Stock Exchange, in a bewildering range of industries. It is bound together by complicated interlocking structures: various central bodies, such as the Tata trusts and Tata Sons, hold shares in the companies.

Tata is also held together by a common culture that has been marinating for 140 years. Employees love to tell tales of how Tata got the better of the British overlords. They also love to point out that Tata created many of India's greatest institutions, such as the Indian Institute of Science, the Tata Institute of Fundamental Research and the Tata Memorial Hospital. Reverence for Jamsetji Tata, the group's founder, borders on ancestor worship: his ever-present busts are garlanded with fresh flowers daily. On March 3rd thousands marched through the streets of Jamshedpur, as they do every year, to celebrate his birthday.

Tata prides itself above all on its culture, which it argues is defined by three things: loyalty, dignity and what is now called corporate social responsibility (CSR). It is not unusual to find a Tata lifer whose spouse works for the firm and whose father also did. Tata is admirably restrained by the flashy-it is tempting to say money-grubbing-standards of modern India. It has always eschewed "sinful" industries such as drink, tobacco and gambling. It is as committed to public service as it was when Jamsetji Tata was laying the economic foundations of Indian independence.

Tata charitable trusts own two-thirds of the holding company, Tata Sons. Alan Rosling, a former Tata executive who spearheaded the group's globalisation, liked to say, "We're making money so that our shareholders can give it away." The trusts funded worthy causes, from clean-water projects and literacy programmes to the various Tata institutions, to the tune of $97m in 2010. But the commitment to CSR is deeper than this.

Consider Jamshedpur, the home of Tata Steel and perhaps the world's most successful company town. Tata Steel runs almost all the city's institutions: these include a 980-bed hospital, a zoo, a giant sports stadium, academies for football, archery and athletics, golf courses and the local utility company. ("They provide you with a house and a car," jokes Prabhat Sharma, head of corporate affairs for Tata Steel. "The only thing you need to bring is a wife.") The company also employs 250 people to work with local tribespeople, to improve agriculture, health care and education, and regularly sends a hospital train farther into the hinterland. The city is remarkably well run by Indian standards, with broad avenues, green parks, reliable power and water that you can drink. Tata Steel gently mocks all this corporate philanthropy with the slogan, "We also make steel".

This largesse has come under some strain in recent years. Tata Steel has reined back some activities (it no longer makes ice or shoes) and created a separate utility company. Tata Tea (now Tata Global Beverages) has sold its vast plantation in the Western Ghat mountains where it was the biggest employer for more than a century. But rationalisation has not gone far by Western standards. The tea plantations were sold to former employees. Tata Steel gave generous pensions to the thousands of workers it got rid of.

The group has inevitably provoked criticism as it has stridden onto the international stage. Western investors who already apply a discount to American and European conglomerates are leery of India's more sprawling variety. Many Indians may view the prominence of Ambanis, Birlas and Tatas as part of the natural order of things. But Westerners tend to associate it with unreconstructed tradition and messy family politics.

The widespread suspicion that Tata had overpaid for Corus and JLR seemed to be confirmed when the world's stockmarkets tumbled in 2007-08. Even Mr Tata admits that the group had to reach deep into its pockets to keep some subsidiaries going. But the crisis has done nothing to damage Tata's growing self-confidence. The global deals are beginning to repay its patience: JLR is likely to make $1 billion in profit this year as well as providing Tata Motors with valuable skills. Mr Tata warns the group against drawing the wrong conclusion from the meltdown: it needs to be more bullish rather than more conservative.

The sense behind the sprawl

Tata executives also insist that the group's sprawl makes sense, even if they sometimes explain it in idiosyncratic terms. R. Gopalakrishnan, a director of Tata Sons, explains the structure with reference to the extended Indian family: the patriarch sets an example to his "sons" and kicks them out of the house if they fail to live up to his values. But they also claim support from management thinkers such as Tarun Khanna, of Harvard Business School, and Jim Collins, the author of "Good to Great".

Mr Khanna points out that diversified groups are the "dominant" form of business in many emerging markets, including Chile, Indonesia, Mexico, Pakistan and Thailand. He argues that this makes eminent sense in countries with weak governments and underdeveloped institutions. India regularly comes in the bottom half of the World Bank's "Doing Business" rankings. Many institutions that Western companies take for granted are missing.

The group's spread not only improves its chances of grappling with bureaucracy and filling various institutional voids but also helps it wage two of the hottest wars in modern India: for talent and trust. Tata can compete with Western talent-magnets such as General Electric and Accenture. It is well enough known to appeal to people in the remotest villages. In last year's BrandFinance Global 500, a ranking of the world's most valuable brands, the Tata name was reckoned to be worth $11.2 billion, placing it first in India and 65th overall. Even the twin strategy of advancing at both the bottom and the top of the market makes sense: it is hard to dismiss Tata as a "cheap" brand when the group owns luxury hotels and fancy consultancies.

Mr Collins argues that "culture" is a rich corporate resource: many of the "great" Western companies that he studies share a propensity for ancestor worship. Tata's culture of probity has helped to insulate it from India's endemic corruption. It has guided its behaviour when standards have slipped: when the company discovered widespread irregularities in Tata Finance in 2001-02 it blew the whistle on itself. Tata has not escaped unharmed from the snowballing scandal over the Department of Telecommunications' decision, in 2008, to allocate wireless spectrum to favoured companies at below market prices. But in general its reputation has earned its senior figures the benefit of the doubt.

Tata's diversified structure has given it a valuable mixture of flexibility and deep pockets. Its companies have been able to seize opportunities, such as Tata Steel's takeover of Millennium Steel or Tata Motors' joint venture with Marcopolo, a Brazilian bus manufacturer. Bombay House provides Tata companies with clout when they want to make ambitious acquisitions (Tetley was twice the size of Tata Tea) or when the market turns against them.

Tata's new frontiers

A profile in *Fortune* in 2002 characterised Tata as both "one of India's most beloved companies" and "a mess". The latter no longer looks correct. But Tata will be held to much higher standards as it competes with the world's best. Its future success will depend on the answers to two questions. Can it use its muscle to become a master of innovation? And can it become a truly global company rather than just an Indian one that does well abroad?

Mr Tata's mission in his final years as chairman has been to foster innovation. He has started an annual competition with a prize for the best failed idea (failure is a "gold mine" for a great company, he says). He has also created five "clusters" (plastics and composites, nanotechnology, engineering, IT and water) that throw people from different businesses together.

The group is pursuing innovation on two levels. At the high end, Tata Chemicals is conducting research in nanotechnology and food science, and TCS holds regular innovation conferences in Silicon Valley. But what has caught more attention is the group's commitment to "frugal innovation": new products designed to appeal to poor people and the rising middle class.

Tata's best-known frugal product, the Tata Nano, a 150,000 rupee car, has run into problems: some cars have suffered from what Ravi Kant, the vice-chairman of Tata Motors, calls "thermal incidents" and his customers call "catching fire". Distribution has been poor, although more are appearing on the roads. Carl-Peter Forster, chief executive of Tata Motors, admitted this week in Geneva that the Nano business model is having to be reinvented.

Even if the Nano proves disappointing, frugal innovation looks promising overall. Tata Motors is making small trucks that are replacing three-wheelers. TCS has co-produced a cheap water filter, the Swach, using ingredients such as rice husks. Tata Steel has made a prototype of a $500 house that can be bought in a shop. The hotel company is building $20-a-night billets for India's army of commercial travellers.

The group is learning to combine the strengths of its various parts. Three companies collaborated on the Swach. After the Asian tsunami in December 2004 TCS and Tata Teleservices joined forces to develop a weather-alert system for fishermen. The group is also marrying high- and low-end innovation. The supercomputer in Pune was built in six weeks for around $30m. TCS has created a cheap software package that can teach adults to read in 40 hours.

The Nano needs sprucing up

In globalising, Tata has been a fast learner, absorbing lessons from JLR and Daewoo. It has become more ambitious: Tata Global Beverages presents itself as a global company rather than an agglomeration of acquisitions. Tata also claims that it is easier for Indian companies to compete in Western markets than it is for Western ones to adapt to the complicated demands of developing markets.

But the group nevertheless faces serious problems. One is the parochialism that afflicts big countries (and companies): the upper management is still dominated by Indians who know only life within Tata. A second is hubris. Tata is too inclined to celebrate the great pruning of the 1990s rather than ask whether another is due. It may not be able to justify today's degree of diversification when the Indian market is growing so rapidly and when it is doing so much business in the developed world. It needs to consider whether it is time to lop off weaker limbs such as Tata Teleservices, an also-ran in India's crowded telecoms market, and Tata Financial Services.

The most immediate task, though, is more humdrum: replacing Ratan Tata. This will not be easy. Mr Tata has driven the group's big transformations from its restructuring to its focus on frugal innovation. His personality pervades the organisation, which is in a far better state than it was when he inherited it.

Tata has plenty of senior executives who have grown up under his regime-not least Noel Tata, Ratan's half-brother and the son-in-law of Pallonji Mistry, Tata Sons' largest individual shareholder. It has also forged a long-term strategy that could power its growth for years: producing a stream of innovative products that will both cater for the rising masses of the emerging world and shake up markets in richer places.

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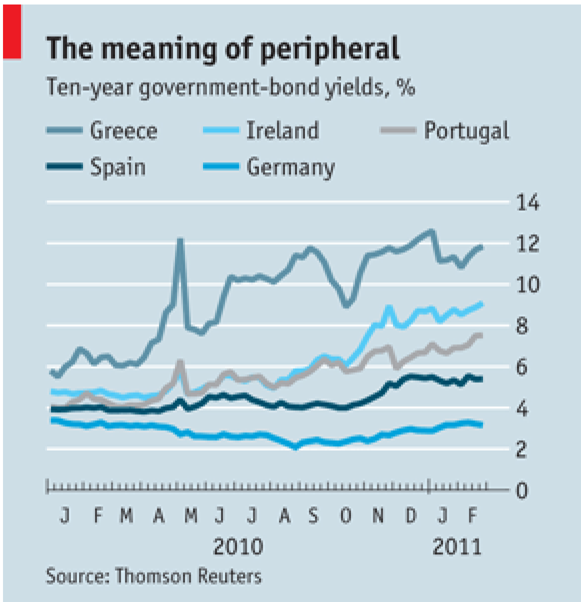
The euro area's debt crisis

Sovereign remedies

The "grand bargain" may prove less grand in reality than in rhetoric

FOR months now European leaders have been striving to get on top of the euro-area debt crisis. But as the deadline for a supposedly comprehensive and enduring solution nears-summits are due to be held on March 11th and March 24th-the "grand bargain" is looking ever less grand. A disappointing outcome will fuel market doubts about the fiscal sustainability of the most troubled euro-area economies. Those doubts remain intense. Ten-year bond yields are sky-high for Greece and Ireland, despite the bail-outs of 2010; at an intolerable level for Portugal, generally seen as next in line for a rescue; and still worryingly high for Spain (see chart).



This being a sovereign-debt crisis, politics has a habit of upsetting the tidy reckonings of market spreadsheets. The Irish election on February 25th may have delivered the predicted outcome in the shape of a new ruling coalition dominated by Fine Gael. But it also injects fresh uncertainty since Enda Kenny, the new Irish leader, has a popular mandate to revisit some of the terms of the bail-out in November. The outcome of his negotiations-chiefly with Germany, the euro area's reluctant paymaster-will in turn help shape a permanent debt-restructuring mechanism that will replace the European Financial Stability Facility (EFSF) when the interim rescue arrangements expire in mid-2013.

Politics has intruded in Germany, too. Angela Merkel's ability to face down domestic opposition to a deal involving big German concessions has been undermined by the drubbing her party took in a recent regional election, and by the forced departure of her defence minister. Awkwardly, the chancellor faces an even more vital verdict from voters, in the big state of Baden-Wurttemberg, on March 27th, just after the second European summit.

Only one firm decision has so far been made in the run-up to the summitry: that the European rescue funds announced last May will actually match the original promise of euro500 billion ($690 billion). Hopes that the EFSF could be used to facilitate a voluntary reduction in debt, notably Greece's towering 140% of GDP, have dwindled. The idea was that it could lend funds to Greece, which would buy back its debt at market prices-ie, at a deep discount to its par value.

On a recent visit to Berlin, George Papandreou, the Greek prime minister, pleaded for such buy-backs to be on the negotiating table. But German opposition to the notion has hardened. In late February, for instance, the Bundesbank, the country's central bank, condemned the idea as an opaque inter-governmental transfer.

Whether buy-backs would help is in any case unclear. As Nouriel Roubini and Brad Setser, two economists, argue in "Bail-outs or Bail-ins?", a book drawing on the experience of debt crises in emerging economies, a determined programme to repurchase bonds would drive up their price, so reducing any relief. Removing debt held by private holders and replacing it with strict obligations to the EFSF could make an eventual restructuring harder, should that prove unavoidable.

Explore our

Whereas excessive public debt in Greece has arisen from years of public profligacy, Ireland's problem has been made acute by the unbearable cost of propping up its oversized and undercapitalised banks. This amounts to at least 36% of GDP, according to Dermot O'Leary, an economist at Goodbody Stockbrokers, helping already to push public debt to almost 100% of GDP. A possible target for write-downs by the new government is the euro21 billion of bank debt (worth 13% of Irish GDP) not covered by state guarantees. But that option is steadfastly opposed by the European Central Bank, which fears it might rock a euro-area banking system that is still far from healthy.

A more realistic objective for Mr Kenny is to bring down the interest rates on the bail-out funds. These were reckoned at the time of the deal in late November to average 5.8% on the euro67.5 billion of external support, two-thirds of which comes from European sources (the remainder is from the IMF). The funding, which has an average maturity of 7.5 years, will protect Ireland from having to borrow in the markets over the next three years. But the Irish will press for a reduction of as much as two percentage points on the European funds, arguing that this high cost of borrowing was originally devised for a serial fiscal offender like Greece rather than a country whose public finances have been laid waste by an unfortunate banking accident.

How much would lower rates help? David Mackie, an economist at JPMorgan Chase, argues that the real prize would be to offer low-cost finance beyond 2013. Otherwise, if Greece and Ireland have to return to the markets, they will have to pay punitive rates that would keep their debt burdens rising even if they are running primary (ie, excluding interest payments) budget surpluses by then. But even if such a concession was achieved, the point at which debt would peak would still be very onerous-over 150% of GDP for Greece and around 125% of GDP for Ireland.

Moreover, securing a more favourable interest rate will be tough. The Bundesbank, for example, is no keener on the idea than it is on bond buy-backs. Other parts of the grand bargain are also in trouble: German proposals to impose Teutonic discipline on the flakier members of the euro area have sparked plenty of opposition. Indeed, some insiders are now saying that European leaders will not be able to resolve their differences in March.

Fears of an adverse reaction in the markets-Portugal's position is looking precarious, with bond yields exceeding the unsustainable level of 7% over the past month-should focus minds enough to produce an agreement. But it looks unlikely to be enough to get ahead of the crisis.

A more fundamental rethink is needed. It may be better to bite the bullet of default, starting with Greece. A recent report from Bruegel, a think-tank, concluded that Greece had become insolvent, called the current wait-and-see approach "a dubious strategy" and said that restructuring was necessary. The main objection to such a policy is the risk of destabilising the European banking system. But that risk could be contained, the authors argued, if banks' weaknesses were addressed following new stress tests, which get under way this month and whose results will be published in June. The idea of resolving the debt crisis through restructuring may still be anathema in official European circles, but it won't go away.

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China's banks

Cognitive dissonance

The numbers say Chinese banks are doing brilliantly. The market is sceptical

IN THE war between China bulls and bears, the country's banks represent an important battleground. The banks are China's most valuable listed firms, accounting for more than a fifth of the entire Hong Kong stockmarket. Their broader significance to China's economy is enormous: they provide the bulk of the country's capital, and their results should, theoretically at least, reflect how well its businesses are performing.

Based on their expected results there is reason only to applaud. Earnings rose by 20-50% in 2010 and analysts are predicting particularly good first-quarter numbers. Profits are growing by more than 20% annually, estimates May Yan of Barclays Capital. Loan losses are vanishingly small. Lending margins are expanding. The potential for fee income is all but untapped. Demand for credit is insatiable. Alternative sources of capital are limited.

Yet the market has its doubts. Though their history as public companies is short, Chinese banks have typically traded at 2.3 times their book value and 12-13 times future earnings. At the moment, however, they trade at 1.5 times book value and eight times expected earnings, levels that ordinarily mark out firms that are vaguely troubled or face brutal competition.

There are many possible explanations for these low prices. Perhaps the best is credit risk. Losses over the past year ran at 40-50 basis points of their loan books for the large banks, a rate that is minuscule for even the most buoyant economy. Ms Yan believes losses will bump up in the coming year, but remain between 50 and 60 basis points, still extraordinarily low.

The bears concede that losses may stay that way for a while, but argue that a huge, government-ordered expansion of bank credit over the past two years in response to the crisis must eventually produce vast losses. The only question is when.

There is particular concern about loans made to entities tied to local governments and to property investors, some of which have been passed along to affiliated trust companies. Argument and counter-argument abound. No one doubts that there are lots of empty flats, but equally no one doubts that there is lots of demand. Plenty of those flats were bought with credit but loan-to-value ratios were, many bankers claim, conservative, while standards are nothing like as loose as in America. One credit officer in a Chinese bank says that far more important than any aggregate statistic is lenders' intimate knowledge of the thick, extraordinarily rich, slice of buyers who can weather a downturn.

Aware of credit-quality concerns, the Chinese banks have been steadily putting aside reserves. Optimists like Barclays Capital's Ms Yan say that even if the reserves were inadequate the central government would intervene and has the

capacity to do so. It has in the past, though that was before the banks had public shares. Would they and their shareholders be spared pain again?

Another concern that hangs over the banks is the central government's moves to restrict credit and cool the economy. The first bit of this policy impedes growth in the volume of banks' assets, the second raises the prospect of borrower insolvency. But even here the debate is nuanced. It would be a surprise if the year ended without double-digit lending expansion. And because banks can reprice their assets faster than their liabilities, interest-rate tightening should push up their net interest margins in future (see chart).

A final concern is whether the banks, given their growth and possible losses, have adequate capital. Here again the debate is fierce. Almost all Chinese financial institutions meet or exceed current global standards, yet capital raising continues. The five largest banks issued securities last year and another three major banks-Minsheng Bank, CITIC and Bank of Shanghai-are expected to tap the market soon. Optimists see this as an opportunity to put money to productive use. Sceptics just sigh. If everything were really going well, they contend, then banks would be spewing out cash, not raising more of it.

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Derivatives

Unlucky for some

Proposed rules on taming swaps markets are proving controversial

SEVEN is a lucky number in some cultures, but for regulators tasked with fleshing out America's Dodd-Frank act on financial reform it is more curse than blessing. Writing rules for Title VII of the law, the section on over-the-counter (OTC) derivatives, is proving devilish.

Few question the push for more regulation. Freewheeling swaps markets were not the main cause of the crisis but they played an unwelcome role, multiplying and masking leverage. The reforms seek to put them on a sounder footing by, among other things, forcing more trading through clearinghouses, exchanges and exchange-like "swap execution facilities" (SEFs).

But as details of the rules emerge, swaps peddlers and their clients are howling. "End-users"-firms, from airlines to brewers, that use swaps to hedge risk-worry that their costs will rise. Big dealers, such as JPMorgan Chase and Goldman Sachs, moan that regulators are rushing things, that they are going beyond the law's intent, and (of course) that there will be "unintended consequences". One consequence they fear is the slaughter of a cash cow: American bank-holding companies made $12.2 billion from derivatives trading in the third quarter of last year.

The two agencies tasked with penning the rules, the Securities and Exchange Commission (security-based swaps) and the Commodity Futures Trading Commission (the rest), face a huge task. The CFTC alone has proposed more than 1,000 pages of rules, with lots more required by a July deadline. On top of this they have to draw up "conforming" amendments in areas where existing rules have to be reworked. No wonder JPMorgan has 350 people trying to get their heads round Title VII.

The regulators get high marks for seeking input. Unusually, they requested comments before they had even proposed any rules (they have received nearly 5,000). And some of the industry's bugbears, like the requirement that banks spin out most swaps activities into non-bank affiliates, were set in stone by the law.

But dealers are still miffed about some of the regulators' proposed rules. As some interpret it, one would impose on them a fiduciary duty towards pension funds and municipalities. Dealers might conclude that they are safer steering clear of such clients if regulators insist on "importing retail compliance standards to an institutional market", as one lawyer puts it.

Banks argue that some rules designed to boost transparency will instead sap liquidity. New requirements on post-trade reporting could make a dealer warier of offering quotes on customised contracts for fear of being "picked off" by rivals as the dealer tries to trade out of its position later. Dealers may also be put off by the CFTC's insistence that swap-trading venues offer a minimum of five quotes for any given transaction. "Sunshine is the perfect analogy," says one banker. "Too much of it in dealer markets and we all get skin cancer."

End-users, too, are anxious. They fret about possibly having to start stumping up initial margin on OTC trades despite assurances from Gary Gensler, the CFTC's chairman, that genuine hedgers will remain exempt. Either way, they can expect dealers to pass on costs as their own capital requirements rise. The oil-price spike has heightened sensitivity over hedging costs.

Another area of concern is regulatory co-ordination. The SEC and CFTC diverge on several issues, including standards for reporting large trades and for quoting prices on SEFs. Cross-border co-ordination has also proved elusive. The European Union is on a slower, somewhat different path. Its derivatives rules will be shaped by the review of its financial-markets directive, expected to take more than two years. American banks worry that they will be at a disadvantage, although some of Europe's final rules are set to be harsher.

America's tight deadline looks set to slip in any case. Mr Gensler says that some rules may not be finalised by July, and implemented only well after that. To some that still looks like indecent haste. Says Annette Nazareth, an ex-SEC commissioner with Davis Polk, a law firm: "Regulators are trying to replicate in a year the kinds of rules and infrastructure that evolved over decades in equities markets."

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Pay in the public sector

Sun, salaries and public servants

The part that mild weather plays in wages

GOVERNMENTS in the rich world are taking the knife to the budgets, pay and pensions of state employees. But where to cut? A study by Jan Brueckner and David Neumark of the University of California, Irvine, finds that within America there may be more flab in public-sector pay packets in states like coastal California than wintry Wisconsin.

The two economists work out the fraction of American workers' pay that cannot be explained by factors such as differences in education and experience. This "wage premium" reflects the extent to which workers have been able to extract more pay than is merited by their qualifications. Those who believe that America's state workers are vastly overpaid will be surprised to learn that this premium is in fact higher in the private sector than in the public sector in many American states. But states where the opposite is true are ones like California, Florida and New York. The authors point out that these are all states offering the sorts of things that attract people from other states-mild, sunny weather in the case of California and Florida, and big metropolitan areas in the case of California and New York. They argue that this is no coincidence.

Public employees' ability to extract higher wages is limited by the willingness of taxpayers to foot the bill. (It is, of course, also limited by laws prohibiting collective bargaining, such as the one causing a storm in Wisconsin.) Making demands that exceed the tolerance of taxpayers at large should induce at least some people to move to other states, reducing the size of the tax base.

But this disciplining mechanism is weaker if the state is one that people want to move to for other reasons, such as milder weather, proximity to the sea or buzzy cities-all factors which the study finds to be positively correlated with the public-private wage differential. In these places the weather may brighten some people's lives in more ways than one.

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Sex and insurance

A boy-racer's dream?

A European court puts an end to sex-based premiums

THERE were howls of protest from the insurance industry when the European Court of Justice ruled on March 1st that a person's sex should not be used to set insurance policies. It will be expensive for some, argued insurers: no more cheap premiums for careful female drivers, and lower annuities for shorter-lived men.

The ruling has unleashed a lively debate on whether actuarial science, which assesses factors such as life expectancy and the propensity to smash cars, could not just as easily use other data besides sex to calculate likely outcomes: eating and driving habits, say, or location and wealth. Actuaries already factor in some of these things, but sex is a simpler proxy-and for things like longevity, a very well-established one.

The court's advocate-general has argued that, given social changes, risk models can no longer clearly be linked to a person's sex. This was a "kind of substitute criterion" for other features and was incompatible with the principle of equal treatment for men and women, she said.

The case was brought by Test-Achats, a Belgian consumer group, arguing that a 2004 European Union directive on equal treatment in goods and services was flawed: a pesky proviso, Article 5(2), had unreasonably given states the option to allow the continued use of sex-based actuarial data to set risk premiums. The judges agreed with Test-Achats and abolished Article 5(2). From December 21st 2012 all new insurance contracts will have to comply with the directive.

Actuaries say that using other factors in their calculations besides sex is perfectly possible. There may be a shock to motor premiums for young women in Britain, but in continental Europe many insurers base their premiums on the car and not the driver. Belgium has had unisex car insurance since 2007 without suffering an underwriting pile-up. Test-Achats says that young people's initial premiums in Belgium converged, but that the no-claims-bonus system means that good drivers of either sex enjoy reductions in later years.

Soothing words from Belgium are not likely to calm the mood in Britain. The big issue is pensions: annuities are far more common in Britain than elsewhere in Europe. A supplementary pension-savings scheme in Germany, the Riester-Rente, has been sex-neutral since 2006. Insiders say that demand by men for Riester pensions has not slackened but they wonder whether that would be true in the absence of state subsidies.

Pricing policies on the basis of characteristics that cannot be altered, like sex, seems unfair to many. A line has already been drawn in the case of genetic testing. Insurance companies in Britain agreed in 2005 that the predictive results of genetic tests should not be used to set certain insurance premiums. That is in keeping with the mutual nature of insurance, whereby many buyers put in more than they get out.

But restricting the ability of insurers to reflect risks in setting premiums causes problems. Insurance firms argue that removing sex as a rating factor will add an uncertainty premium to everyone's bill. Using more detail on individuals' characteristics will also add to costs. If higher premiums discourage people from saving up for an annuity, for example, the court's judgment will end up helping no one.

The battle for Grameen

Halo, goodbye

Attacks on the sainted Muhammad Yunus escalate

FIRST, trenchant criticism. Late last year Bangladesh's prime minister, Sheikh Hasina, accused Muhammad Yunus, the founder and managing director of Grameen, the world's best-known microfinance institution, of playing "a trick" to evade taxes. Then, broad hints that Mr Yunus might consider quitting: "At 70, Professor Yunus is five years beyond the retirement-age limit for bank managing directors in Bangladesh," the finance minister said in February. Now, direct action. The country's central bank wrote to Grameen's board on March 2nd, informing it that Mr Yunus had been "relieved of his responsibilities as managing director of Grameen".

The letter echoed the finance minister, though inexactly, saying that it was against government rules for Mr Yunus to stay on as managing director beyond the age of 60. Both Mr Yunus and Grameen's non-government-appointed directors have challenged the decision; Grameen said that he was "continuing in his office". The matter is unlikely to be resolved immediately.

The bad blood between Mr Yunus and Sheikh Hasina is thought to stem from the former's abortive attempt to set up a political party in 2007, when he called for a "complete emasculation" of the country's established parties. Some reckon that the sheikh is miffed at Mr Yunus and Grameen because they won the 2006 Nobel peace prize.

But Mr Yunus has many supporters, both within Bangladesh and outside it. Several Bangladeshi economists have sprung to his defence, making the reasonable point that any transition should be orderly so as not to harm Grameen. Friends of Grameen, a voluntary organisation headed by Mary Robinson, a former president of Ireland and ex-head of the UN's human-rights agency, denounced what it called "the new attempt of destabilisation against Professor Yunus". According to reports in the Bangladeshi press, the issue of the government's treatment of Mr Yunus has led America to threaten to suspend all high-level diplomatic contact.

The issue goes beyond Mr Yunus. Some fret that the government's actions could spark fears about Grameen's stability, even leading to a run on the bank, which offers savings accounts as well as loans. If so, then the biggest losers from the government's bullying would be Grameen's 8.35m clients, almost all of them poor Bangladeshi women.

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Global house prices

Hong Kong phew-whee

Our quarterly index reveals the world's most overvalued homes

The Economist house-price indicators

% change

	Latest	Q4 2009	1997-2011*	Under(-) / over(+) valued†
	On a year earlier			
Hong Kong	20.1	23.1	-1	53.7
Singapore	17.6	1.8	21	18.1
France	8.6	-4.4	152	48.0
China	6.4	5.8	na	12.9
Belgium	6.0	1.0	164	23.7
Australia	5.8	13.9	215	56.4
Sweden	5.2	7.1	175	39.5
Switzerland	4.2	6.2	37	5.5
South Africa	2.9	4.9	421	na
Denmark	2.7	-5.1	98	17.6
Germany	2.6	-3.7	na	-12.2
Canada	2.4	-1.2	69	11.4
Netherlands	1.7	-1.6	90	20.8
New Zealand	0.9	5.2	111	20.6
Britain	-1.1	3.5	178	29.6
United States (Case-Shiller ten-city index)	-1.2	-4.5	95	3.0
United States (FHFA)	-1.3	-4.3	70	10.2
Italy	-1.6	-4.1	93	8.7
Spain	-3.5	-6.3	157	43.7
Japan	-3.6	-4.0	-38	-35.2
United States (Case-Shiller national index)	-4.1	-2.4	56	-7.7
Ireland	-10.8	-18.5	118	19.9

*Or most recent available figure †Against long-run average of price-to-rents ratio

Sources: ABSA; ESRI; Hypoport; Japan Real Estate Institute; Nationwide; Nomisma; NVM; FHFA; Quotable Value; Stadim; Swiss National Bank; Standard & Poor's; Thomson Reuters; government offices; *The Economist*

IN CROWDED Hong Kong, property is so expensive that even the estate agents are squeezed for space. The number of licensed agents reached 31,306 at the end of last year, an increase of 40% since March 2009. The qualifying exam is so popular that fees are going up. Golden Hill Properties in Wanchai makes do with a storefront but no store. Its agents perch on stools outside, reading from computer screens encased behind glass and typing on keyboards unlocked from a drawer.

But whatever those 31,000 agents say, Hong Kong homes are not a good deal, according to our latest global house-price index (see chart). In theory, the price of a home should reflect the value of the services it provides. People who choose to rent their homes buy those services on a monthly basis. Home prices should therefore reflect the rents that tenants pay. Our index calculates the ratio of prices to rents in 20 economies. In Hong Kong, that ratio is now almost 54% above its long-run average-and it is still rising.

People in Hong Kong often blame buyers from mainland China for pushing up prices. Ironically, mainlanders often blame buyers from Hong Kong for their own property frenzy. At a recent conference at Tsinghua University in Beijing, students complained that their parents had scrimped and saved to send them to university in the city, but now upon graduation they could barely afford to live there.

Prices in China are not that high relative to rents: our index suggests that homes are overvalued by less than 13%. But this is based on the government's 70-cities index, which showed prices rising by only 6.4% in the year to December. That figure seemed implausibly low to many of China's stretched homebuyers, and the Chinese government appears to share their scepticism. Last month it said it would stop publishing the national figures, releasing only the local results instead. These show plenty of variation between cities: prices rose by 6.8% in Beijing in January, for instance, but by 1.5% in Shanghai.

Hong Kong's price rises are the steepest in our index but it is not the most overvalued housing market. That honour remains with Australia, which is overvalued by about 56%. In third place is France, where the ratio of prices to rents is about 48% above average. That may be one reason why over 40% of residents choose to rent. Tenants are well protected under French law from capricious landlords. Owners, on the other hand, must contend with volatile prices, partly because housing supply is so unresponsive to demand. A 10% increase in prices prompts only a 3.6% increase in supply, according to the OECD, compared with a 20% increase in America.

Explore and compare global housing data with our

In Australia the market is at least inching closer to fair value. Home prices in Australia's eight state capitals rose by only 1.2% in the year to January, according to the RP Data-Rismark index. Compared with the month before, prices fell by 1.6%. (The index shows the latest quarterly data.)

Indeed, only in Hong Kong, Singapore and Switzerland is the property market more overvalued than it was before the global economic downturn began in the third quarter of 2007. In every other market the ratio of prices to rents has fallen over that period. In America, prices may have overshot a little. Using the Case-Shiller index of prices, the market looks undervalued by almost 8%.

In both Japan and Germany the housing market is drifting even further below fair value: homes were already cheap and are growing cheaper. In Germany the ratio of prices to rents has tended to fall since the early 1980s, a trend interrupted, and then briefly, only by unification.

In Japan owning has been getting cheaper relative to renting since 1990, when the country's infamous property bubble burst with devastating effect. The market is now undervalued by more than a third, our index suggests. Even estate agents seem to be losing heart. According to the Real Estate Transaction Improvement Organisation, their numbers have fallen for the past four fiscal years.

Galleon Group

The charging of Rajat Gupta

Misery loves company. The Securities and Exchange Commission (SEC) has now charged 22 people for illegally exchanging inside information as part of the Galleon Group hedge-fund case. The latest is Rajat Gupta, a former boss of McKinsey, a consultancy. He was charged this week for feeding tips to Raj Rajaratnam, who ran Galleon. Galleon raked in around $15m and avoided losses of around $3m as a result, the SEC alleges. Both Mr Gupta and Mr Rajaratnam deny wrongdoing. Interest in Mr Rajaratnam's trial, due to begin on March 8th, will be immense. Mr Gupta is the biggest figure to be ensnared so far, having once served as a board member of Goldman Sachs and, until this week, of Procter & Gamble, a consumer-goods giant. It is one thing to topple a fund manager, another to bring down a major figure in corporate America.

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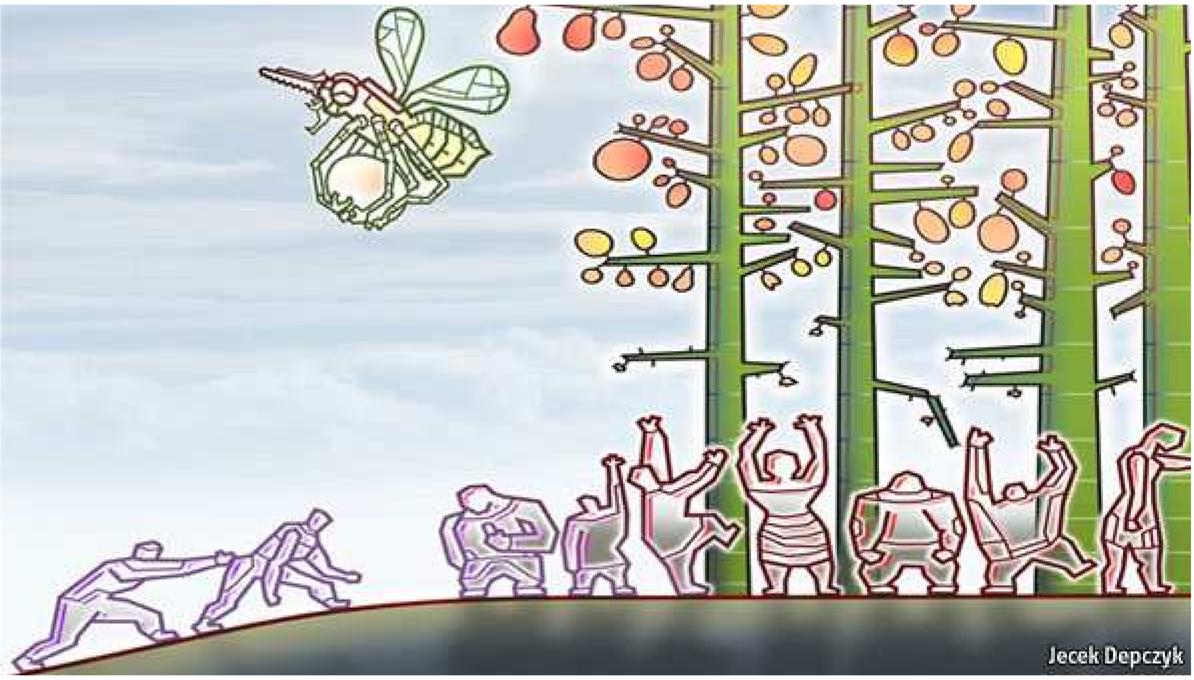
Economics focus

Stagnation or inequality

Has the American economy exhausted the easy sources of growth?



YOU could be forgiven for missing the publication of the most talked-about economics book of the year so far. The author, Tyler Cowen, an economist at George Mason University, quietly announced its release in a post on his blog. "The Great Stagnation" is an e-book*, and at just 15,000 words, a slim one at that. But it has inspired a raucous discussion in the blogosphere which has spilled over to mainstream media.

The book explores the puzzling stagnation in the typical American wage since the 1970s. The prevailing view has been that soggy median wages can be explained by widening income inequality. But Mr Cowen blames lagging pay on a shortfall in growth itself. Output data have been overstated, he reckons, thanks to rising contributions from hard-to-value industries. Worse, economic engines in the rich world are running ever slower as countries exhaust easy sources of rapid growth.

The numbers do not appear to support Mr Cowen's story. Growth and productivity performed badly in the years after the oil shock of the 1970s, but by the 1990s a turnaround was under way. Productivity rose by 2.8% a year from 1996 to 2000, and faster still in the next five years. Real output growth topped 4% a year from 1997 to 2000. This is stagnation? But Mr Cowen says these figures are illusory. Rising output in the health-care or government sectors may not correspond to real improvements: expensive surgery may become more common without improving health. Finance enjoyed impressive productivity gains before the crisis but produced many goods of questionable value.

If America's past was not as impressive as it seemed, its future is even more troubled. Mr Cowen argues that there is a dwindling supply of "low-hanging fruit": opportunities for fast development that cannot easily be repeated. The plentiful supply of land once available to settlers moving west is one example. Educational gains are another. In 1900 many of America's best minds were to be found on farms. Now most go to college. But that momentous shift was a one-off. To move students not currently earning degrees through university will be far more difficult.

Worse still, Mr Cowen reckons that the gains from two centuries of rapid technological innovation are largely exhausted, and that new discoveries lack the same revolutionary quality. To take one example, a kitchen from 1973, complete with refrigerator, microwave oven and dishwasher, would strike a person living in 1900 as a marvel. A time-traveller from 1973, on the other hand, would find a modern kitchen fairly ordinary. The world has gone from great leaps to refinements, and the refinements are petering out. Mr Cowen cites Charles Jones, an economist who uses deconstructed growth statistics to determine the drivers of progress across eras. Mr Jones reckons that 80% of the growth between 1950 and 1993 came from the new application of old ideas, and these old ideas are now mostly wrung dry. Other data point in a similar direction: rich economies spend more than ever on research, but the number of new patents has plateaued.

Innovation continues, of course. Those ubiquitous smartphones are not a figment of your imagination. But new discoveries no longer translate into broad income gains, the book argues. A nifty fashion design or structured financial product may enrich its creator without benefiting society as a whole. The most transformative of modern innovations-the internet-generates fewer jobs and revenues than past technologies. General Motors once employed over 600,000 people; Facebook serves 500m customers with a staff of 2,000. Americans spend and borrow much as before the advent of the web.

Mr Cowen's thesis contrasts with what might be called the "Great Divergence", which argues that the distribution of income gains is the problem, not the actual growth rate. Some economists, such as Claudia Goldin and Lawrence Katz, trace the growing pay gap to increasing demand for skilled workers. Others fault the policy environment. Paul Krugman credits the Reagan-era assault on labour unions and regulations with a decline in workers' bargaining power. The result is a new gilded age, in which plutocrats capture the surplus generated by an exploited class of workers. These competing views of America demand very different policy responses. For the likes of Mr Krugman, progressive taxation and redistribution are needed to offset labour's position of weakness. A stagnating world, on the other hand, requires a more limited state, lest expanding commitments outrun a slow-growing economy's ability to fund itself.

Stay out of the kitchen

The divergence camp seems to have the better arguments. Productivity improvements eliminated many middle-skilled American jobs just as emerging-market industrialisation undermined the position of low-skilled workers. After adjusting for these factors there may not be much wage stagnation left to explain. Nor is it clear that innovation has slowed. The evidence of improvement is all around. Communication is dramatically cheaper, easier and better than it was just a decade ago. Kitchens may look much as they did 30 years ago but living rooms and desktops look remarkably different. Innovation plateaus have been identified before, often to the later embarrassment of their spotter.

And yet the idea of a great stagnation cannot be dismissed entirely. Rich countries have captured the easy gains from land use and education. Rising dependency ratios are starting to weigh on growth. Rapid industrialisation across the emerging world poses big challenges, not least to the rich world's reliance on cheap resources. Fast rates of expansion cannot be taken for granted; nor can the ability of the state to offer ever more protection to its citizens. A small book but a big, worthwhile question.

* "The Great Stagnation; How America Ate All the Low-Hanging Fruit of Modern History, Got Sick, and Will (Eventually) Feel Better", by Tyler Cowen, January 2011

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Psychiatry

Therapist-free therapy

Cognitive-bias modification may put the psychiatrist's couch out of business

THE treatment, in the early 1880s, of an Austrian hysteric called Anna O is generally regarded as the beginning of talking-it-through as a form of therapy. But psychoanalysis, as this version of talk therapy became known, is an expensive procedure. Anna's doctor, Josef Breuer, is estimated to have spent over 1,000 hours with her.

Since then, things have improved. A typical course of a modern talk therapy, such as cognitive behavioural therapy, consists of 12-16 hour-long sessions and is a reasonably efficient way of treating conditions like depression and anxiety (hysteria is no longer a recognised diagnosis). Medication, too, can bring rapid change. Nevertheless, treating disorders of the psyche is still a hit-and-miss affair, and not everyone wishes to bare his soul or take mind-altering drugs to deal with his problems. A new kind of treatment may, though, mean he does not have to. Cognitive-bias modification (CBM) appears to be effective after only a few 15-minute sessions, and involves neither drugs nor the discussion of feelings. It does not even need a therapist. All it requires is sitting in front of a computer and using a program that subtly alters harmful thought patterns.

This simple approach has already been shown to work for anxiety and addictions, and is now being tested for alcohol abuse, post-traumatic-stress disorder and several other disturbances of the mind. It is causing great excitement among researchers. As Yair Bar-Haim, a psychologist at Tel Aviv University who has been experimenting with it on patients as diverse as children and soldiers, puts it, "It's not often that a new evidence-based treatment for a major psychopathology comes around."

Don't talk about it, just do it

CBM is based on the idea that many psychological problems are caused by automatic, unconscious biases in thinking. People suffering from anxiety, for instance, may have what is known as an attentional bias towards threats: they are drawn irresistibly to things they perceive to be dangerous. Similar biases may affect memory and the interpretation of events. For example, if an acquaintance walks past without saying hello, it might mean either that he has ignored you or that he has not seen you. The anxious, according to the theory behind CBM, have a bias towards assuming the former and reacting accordingly.

The goal of CBM is to alter such biases, and doing so has proved surprisingly easy. A common way of debiasing attention is to show someone two words or pictures-one neutral and the other threatening-on a computer screen. In the case of social anxiety these might be a neutral face and a disgusted face. Presented with this choice, an anxious person instinctively focuses on the disgusted visage. The program, however, prods him to complete tasks involving the neutral picture, such as identifying letters that appear in its place on the screen. Repeating the procedure around a thousand times, over a total of two hours, changes the user's tendency to focus on the anxious face. That change is then carried into the wider world.

Emily Holmes of Oxford University, who studies the use of CBM for depression, describes the process as like administering a cognitive vaccine. When challenged by reality in the form of, say, the unobservant friend, the recipient of the vaccine finds he is inoculated against inappropriate anxiety.

In a recent study of social anxiety by Norman Schmidt of Florida State University and his colleagues, which involved 36 volunteers who had been diagnosed with anxiety, half underwent eight short sessions of CBM and the rest were put in a control group and had no treatment. At the end of the study, a majority of the CBM volunteers no longer seemed anxious, whereas in the control group only 11% had shed their anxiety. Although it was only a small trial, these results compare favourably with those of existing treatments. An examination of standard talk therapy carried out in 2004, for instance, found that half of patients had a clinically significant reduction in symptoms. Trials of medications have similar success rates.

The latest research, which is on a larger scale and is due to be published this month in *Psychological Science*, tackles alcohol addiction. Past work has shown that many addicts have an approach bias for alcohol-in other words, they experience a physical pull towards it. (Arachnophobia, a form of this bias that is familiar to many people, works in the opposite way: if they encounter a spider, they recoil.)

This study, conducted by Reinout Wiers of the University of Amsterdam and his colleagues, attempted to correct the approach bias to alcohol with CBM. The 214 participants received either a standard addiction treatment-a form of talk therapy-or the standard treatment plus four 15-minute sessions of CBM. In the first group, 41% of participants were abstinent a year later; in the second, 54%. That is not a cure for alcoholism, but it is a significant improvement on talk therapy alone.

Many other researchers are now exploring CBM. A team at Harvard, led by Richard McNally, is seeking volunteers for a month-long programme that will use smart-phones to assess the technique's effect on anxiety. And Dr Bar-Haim and his

team are examining possible connections between cognitive biases and post-traumatic-stress disorder in the American and Israeli armies.

Not all disorders are amenable to CBM. One study, by Hannah Reese (also at Harvard) and her colleagues, showed that it is ineffective in countering arachnophobia (perhaps not surprising, since this may be an evolved response, rather than an acquired one). Moreover, Dr Wiers found that the approach bias towards alcohol is present in only about half of the drinkers he studies. He hypothesises that for the others, drinking is less about automatic impulses and more about making a conscious decision. In such cases CBM is unlikely to work.

Colin MacLeod of the University of Western Australia, one of the pioneers of the technique, thinks CBM is not quite ready for general use. He would like to see it go through some large, long-term, randomised clinical trials of the sort that would be needed if it were a drug, rather than a behavioural therapy. Nevertheless, CBM does look extremely promising, if only because it offers a way out for those whose answer to the question, "Do you want to talk about it?" is a resounding "No".

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Intelligence testing

Who are you calling bird-brained?

An attempt is being made to devise a universal intelligence test

WHAT is the IQ of a chimpanzee? Or a worm? Or a game-show-winning computer program? Or even an alien from the planet Zaarg who can learn any human language in a day, can beat chess grandmasters ten at a time and can instantly factor the products of large prime numbers? At the moment it is impossible to say. IQ tests depend on language, and even Watson, a computer program that beat two human contestants in a special edition of "Jeopardy!" (an American quiz show) on February 16th, does not have a perfect command of English. In any case there is, at the moment, no meaningful scale on which non-human intelligence can be compared with the human sort.

The most famous test for artificial intelligence is that devised by Alan Turing, a British computing pioneer. To pass the Turing test, and thus be considered intelligent, a program must fool a human being into believing that it is another human being. But the Turing test still requires the program to share a language with the tester and, because it is all or nothing, cannot be used to rank different forms of artificial intelligence against one another.

Jose Hernandez-Orallo of the Polytechnic University of Valencia, in Spain, and David Dowe of Monash University, in Australia, think they can do better than this. They believe not only that a universal scale of intelligence can be devised, but also that it can be assessed without reference to language. If they are right, an insult like "bird-brained" will, in the future, be finely calibrated.

Dr Hernandez-Orallo and Dr Dowe, both computer scientists, propose to make their measurement by borrowing a concept called Kolmogorov complexity from information theory, a branch of computer science. The Kolmogorov complexity of a computer's output is the shortest possible program (measured in the binary digits that lie at the bottom of all computer code) that could produce that output. On this measure, an entity's intelligence would be measured by the Kolmogorov complexity of the most complex tests it can solve-a clear, numerical value. In practice, calculating the true Kolmogorov complexity of a system is almost impossible. But an approximation can be made. And that, the researchers reckon, will be good enough.

The actual tests would employ the well-honed methods of operant conditioning, developed initially on pigeons, in which the test subject has first to work out what is going on by trial and error. As in operant conditioning, correct responses would be rewarded-by money, perhaps, for a human being; by bananas for a chimpanzee or by the numerical value itself for an appropriately programmed computer.

If the test were noughts and crosses, the test-taker (if it had never seen the game before) would first have to work out that the game is won by getting three in a row on a 3-by-3 grid, before actually going on to play. A chimpanzee might not manage a test of this level of complexity, but could, maybe, work out the idea of three-in-a-row when only a single row was involved. Chess, though, would surely be beyond it (and probably beyond most people, too, if they did not already know the rules). Games like draughts and dominoes would lie somewhere in between.

In fact Dr Hernandez-Orallo and Dr Dowe do not plan to use existing games. Instead they are employing a computer to generate novel games and patterns. Their approach eliminates human bias. It also allows them to generate tests with any level of complexity they like-even ones that are far beyond the ability of humans to complete. When it comes to testing the tests, then, aliens from the planet Zaarg will be particularly welcome to apply.

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Creutzfeldt-Jakob disease

Breaking down the barrier

A glimmer of hope for a drug that treats disease caused by prions

THE epidemic of mad-cow disease in people that some forecast in the 1990s has not, fortunately, come to pass. But Creutzfeldt-Jakob disease (CJD), to give its proper name, is still a nasty illness that humanity would be better off without.

It is also a strange illness. CJD and a handful of similar neurological conditions are caused by the misfolding of a particular protein that is found in the membranes of certain nerve cells. The strangeness is that the misfolded protein, known as a prion, somehow catalyses other molecules of the protein to misfold in the same way. The result is a chain reaction in which more and more protein ends up as prions.

Nerve cells containing the prions stop working. The sufferer endures memory loss, personality changes and spontaneous, jerky bodily movements. Eventually, the disease kills him. A drug to treat CJD would therefore be welcome. And chemicals that seem either to prevent the misfolding, or to help the body clear away misfolded molecules, do, indeed, exist. The problem is turning at least one of those chemicals into an effective medicine.

Adam Renslo of the University of California, San Francisco, and his colleagues (who include Stanley Prusiner, the Nobel laureate who discovered prions) have been trying to do so. The chemicals they have lighted on are called aminothiazoles. These are quite effective in reducing the prion levels of cultured nerve cells.

Testing aminothiazoles in Petri dishes is, however, rather different from testing them on living animals. A natural barrier exists between the bloodstream and the brain, to protect it from harmful chemicals. This barrier interprets many putative drugs, including aminothiazoles, as harmful, and thus keeps them out. And if a molecule cannot cross the barrier, it will not make an effective neurological treatment. Dr Renslo and his colleagues have therefore been analysing and modifying the chemical structure of aminothiazoles to see if this can enable them to cross the blood-brain barrier. As they report in the *Journal of Medicinal Chemistry*, they think they have now pulled off the trick.

They did it by removing groups of atoms called hydrogen-bond donors from the original molecules and adding a ring of carbon and hydrogen atoms. That made the aminothiazoles look more like cholesterol-which despite its malign everyday reputation is an important component of brains and routinely crosses the blood-brain barrier.

It worked. When Dr Renslo fed mice a diet containing the improved aminothiazoles, he found that the most promising of them accumulated in the brain in concentrations nearly 25 times higher than those required to clear prions from cultured cells. The molecular changes did not, though, seem to change the aminothiazoles' prion-killing attributes. When tested in Petri dishes, the new molecules were as good as their precursors. More importantly, preliminary results suggest they are effective at extending the lives of prion-infected mice. Such mice lived for 100 days longer when treated with the new molecules than they did when untreated. That is a significant fraction of the two to three years a healthy laboratory mouse might be expected to survive if it is not experimented on.

Trials in mice are, of course, just the beginning. But breaching the blood-brain barrier in this way is a crucial step, and one that might be generalised to potential treatments for other brain diseases-Alzheimer's, for example. If that came to pass, this small step on the journey of drug discovery might come to be seen, in retrospect, as a giant leap.

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Climate change

Claws!

Crabs are invading the shallow waters of the Southern Ocean

Peek-a-boo. I see you

ANTARCTICA is a peculiar place. For instance, unlike those in most parts of the planet, the ocean depths around it are warmer, at 5Â°C or so, than the shallows near the coast. Here, the temperature hovers around 0Â°C and can drop to -2Â°C. As a consequence, the animals of the Antarctic continental shelf have been free for millions of years from the attentions of predators, such as crabs and sharks, that cannot cope with the cold. The result is an unusual bunch of sea lilies, brittle stars, giant ribbon worms and molluscs that are armoured only with thin, soft shells.

But not, perhaps, for much longer-for crabs are on the march. In the past few years several groups of researchers have spotted king crabs on the continental slope of Antarctica. This slope, which connects the deep ocean with the continental shelf, and whose waters have an average temperature of between 1ÂºC and 5ÂºC, is a marginal habitat for king crabs. They die when the temperature drops below 1ÂºC because they are then unable to process magnesium ions. In small quantities, these ions are needed for energy metabolism. Too many, though, act as a narcotic that eventually kills the animal. Worryingly for sea-lily lovers, the latest research suggests the crabs may be creeping up the slope.

The expedition which made this discovery ended in January. On it, Sven Thatje of Britain's National Oceanography Centre and his colleagues found hundreds of king crabs-beasts that grow to up to 20cm across, excluding their spindly legs-in waters that had been crab-free on the previous survey, in 2007. They did so by towing a submersible called SeaBED, which belongs to the Woods Hole Oceanographic Institution, in Massachusetts, along a 30-nautical-mile transect of Marguerite Bay, off the west coast of the Antarctic peninsula.

As SeaBED cruised over its eponymous target, its cameras took pictures every three seconds and its sensors measured the temperature, salinity and depth of the water. The result is 130,000 images showing hundreds of king crabs, together with details of their immediate environments. All of the crabs were still on the continental slope, but some of them were in shallower water than any seen in 2007. The question, yet to be answered, is whether that was a result of the vagaries of sampling, or because local waters are warming up.

Warming there has certainly been. Since the 1950s, when records began, the average temperature of the ocean to the west of the Antarctic peninsula has gone up by 1ÂºC. That has expanded the region in which king crabs might live. How much longer it will be before they invade the rich uplands of the continental shelf is hard to say. But, like the monsters in a bad sci-fi film, they are coming.

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New model metropolises

Paradises on earth

How cities will evolve

Aerotropolis: The Way We'll Live Next. By Greg Lindsay and John Kasarda. *Farrar, Straus & Giroux; 480 pages; $30. Allen Lane; pound14.99.* Buy from Amazon.com, Amazon.co.uk

Edgelands: Journeys Into England's True Wilderness. By Paul Farley and Michael Symmons Roberts. *Jonathan Cape; 272 pages; pound12.99.* Buy from Amazon.co,uk

WHAT is a city? These two books, though different in style and approach, come to similar conclusions. The city as a metropolitan core containing jobs and shops, surrounded by residential neighbourhoods to which it is connected by roads and rail, the whole eventually giving way neatly to countryside, is no longer an accurate description of how our urban areas work. And cities are likely to diverge even more from this in future.

In "Aerotropolis", John Kasarda of the University of North Carolina and his co-author, Greg Lindsay, convincingly put the airport at the centre of modern urban life. What may appear to be merely a means of travelling from the inconvenient edge of one city to the edge of another is becoming, whether by design or as a result of millions of personal decisions, the centre of the metropolis.

Denver airport seemed absurdly far from the city when it opened in 1995. But the city has moved towards it. Suburbs such as Green Valley Ranch and Reunion have rapidly grown nearby-or did, before the housing crisis struck. People who use airports a lot want to live close to them. In 2009 airlines carried more than 2 billion passengers. Perhaps 300,000 people have flown a million miles or more in their lifetimes-equivalent to two trips to the moon and back.

Airports are magnets for jobs as well as people. Memphis airport is the home of Federal Express, a company that accounts for a sizeable portion of the local economy. Fairfax County in northern Virginia owes its wealth to Dulles airport, which has lured high-tech businesses. The Netherlands would not be the centre of the global flower trade were it not for Schiphol airport. Frankfurt's airport allows the city to play a key role in the fish trade, despite being hundreds of miles from the sea.

Airports are also noisy and polluting. In Britain and America expansion plans are often stymied by vocal protesters. Messrs Lindsay and Kasarda defend them on environmental grounds; it may be better to grow flowers in Kenya and fly them to Europe than to grow them locally in a greenhouse heated by fossil fuels. They also suggest that airports can help reverse suburban sprawl.

But "Aerotropolis" tends not to let the messy business of human desires and worries stand in the way of a good plan. The authors seem most excited by the aerotropolises now rising in places like China, where villages are being forcibly relocated to make way for runways and environmental objections are drowned out by the roar of bulldozers. The fact that airports are often built with taxpayers' money, that people dislike them even as they find them essential, and that air travel is cheap only because carbon and noise are inadequately priced, are not given their due weight in this book. Arguing that airports are bound to become more central to our lives is one thing; arguing that they ought to be is another.

If "Aerotropolis" occasionally overlooks the untidy aspects of modern urban life, "Edgelands" is obsessed with them. This is a book about rubbish tips, self-storage warehouses, out-of-town business parks and, yes, the uninhabitable neighbourhoods under flight paths. Travelling mostly around northern England, Paul Farley and Michael Symmons Roberts, both of them British poets, find unexpected pleasures: a car gradually coming into view beneath the surface of a pond, like a photograph in a developing tray; children's dens; a herd of water buffalo.

"Edgelands" is sprawling and untidy, like its subject matter. But it reminds the reader of two things about cities. First, people have a habit of thwarting plans; one architect's urban park is another man's caravan site, or mattress dump. Second, cities evolve in unexpected ways. Canals were the cargo airports of their day, used to carry the raw materials that powered

Britain's industrial revolution. (A 19th-century urban booster might have called Manchester a "canalotropolis".) Now canals are places where you go to walk the dog while worrying about muggers.

A biography of Earth

Sacred mysteries

An Australian scientist explores where we are now

Here on Earth: A Natural History of the Planet. By Tim Flannery. **Atlantic; 336 pages; $25. Allen Lane; pound14.99.** Buy from Amazon.com, Amazon.co.uk

TIM FLANNERY, an Australian mammalogist and palaeontologist, is an environmental celebrity. His 2005 book, "The Weather Makers", about climate science and global warming, was a bestseller. His latest is his most ambitious book so far. The publisher calls "Here on Earth" a twin biography, of humanity and the planet it inhabits, but that description is inadequate. Mr Flannery's subject is the likely fate of humankind, and whether the powers granted to modern civilisation by science and technology will prove to be its downfall or its salvation.


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He muses on whether humanity counts as a superorganism (a classification usually reserved for bees and ants), why we have yet to discover intelligent aliens, the poorly understood effects of dumping industrial chemicals into the environment, the power of planet-watching networks of satellites and the benefits of aboriginal scrub-burning. There is an effort to organise the chapters around two competing models of human behaviour, a co-operative, far-sighted wisdom that Mr Flannery dubs the "Gaian" approach and a reckless, ultimately destructive short-termism that he calls "Medean", after the bloodthirsty enchantress of Greek myth.

The trouble is that the subject is far too big to fit comfortably into a book a little more than 300 pages long. Mr Flannery is a respected biologist with plenty of published papers to his name, but the book feels dilettantish, with a dizzying array of concepts introduced, briefly discussed, then dispensed with before the reader has had time to digest them. The question of whether modern democracies can successfully resist populist tyranny is raised and then abandoned within two paragraphs. A discussion of decarbonising the world's transport networks flashes by in a handful of pages. Fewer examples more deeply explored might have added up to a more convincing case, and an easier read.

That is a shame, because much of the material would repay a deeper look. The "Gaia" theory, which is the subject of the opening chapters, starts with the surprising observation that such things as the Earth's surface temperature and the salinity of its oceans have fluctuated remarkably little over billions of years despite, for instance, a significant increase in the power of the sun. James Lovelock, who first proposed the Gaia theory, used an analogy with living organisms, all of which can, to some degree, regulate conditions within their own bodies. The theory brings to mind New Age crankery, and some of the research Mr Flannery cites to underpin it is speculative at best. For example, he mentions a scientific paper that suggests that lichens, bacteria and the like may have been a driving force behind prehistoric geology and the formation of continents. Mr Flannery admits that the idea is "controversial". But having shown the reader a glimpse of this fascinating byway, he speeds straight past, impatient to reach the next intellectual stop, while the tentative theory is simply accepted.

If the book is not all it could be, it is still worth reading, though less for answers than for its interesting hypotheses. It is healthy to be reminded of the various ways in which humans are influencing their environment-most of them malign-and to recognise that even in an age of high technology, our prosperity and well-being depend on our natural environment, which furnishes us with air, water, food and the natural resources on which industrial civilisation relies.

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New fiction

Outlook swampy

Ava Bigtree, the new Scout Finch

Swamplandia! By Karen Russell. *Knopf; 336 pages; $24.95. Chatto & Windus, pound12.99.* Buy from Amazon.com, Amazon.co.uk

CHILD narrators are often too precocious or too cute to work in novels. But when a story is capably carried on small shoulders-a Huck Finn, say, or a Scout Finch-the result can be a fine mix of guilelessness and something wistful. If all melancholic yarns essentially knit naivety with nostalgia, then a young hero can be a heady thing.

Such is the case with Ava Bigtree, the 13-year-old at the centre of "Swamplandia!", Karen Russell's impressive debut novel. Ava is the scabby-kneed runt of the Bigtree "tribe", a family of alligator wrestlers that has long managed a gator-themed park in south-west Florida. With their showbiz face-paint and feathery headdresses, the Bigtrees are all makeshift lore and razzle-dazzle. Ava's grandfather, a miner's son from Ohio, inadvertently bought the alligator-infested swamp as farmland, sight unseen. He saw a silver lining, took on the name Sawtooth Bigtree (tossing aside "Ernest Schedrach"), invented some Seminole ancestry and transformed what he could into Swamplandia!, a ramshackle tourist attraction known for its shows of gator daredevilry, starring the luminous Hilola Bigtree, Ava's mother.

However, this story begins as the Bigtrees are in decline. Grandpa Sawtooth is shuffled off to a retirement home after he bites a tourist. The seemingly invincible Hilola has succumbed to ovarian cancer, leaving behind her three home-schooled children and robbing Swamplandia! of its star turn. A new hell-inspired theme-park called the World of Darkness (main attraction: the Tongue of the Leviathan ride) has diverted any remaining tourists from their park, leaving Ava's father chasing after solvency. Her sister elopes with a ghost, and her pimply brother struggles to make a life for himself elsewhere. Bigtree grown-ups are mythical and absent; the children fend for themselves, armed with electric imaginations and little else.

But this is really Ava's story, set against the lonesome fecundity of the swampscape. Ms Russell has produced a rich and humid world of spirits and dreams, buzzing mosquitoes and prehistoric reptiles, baby-green cocoplums and marsh rabbits, and musty old tomes about heroes and spells. With Ava she has created a goofy and self-conscious girl who is young enough to hope that all darkness has an answering lightness. Inevitably she must learn otherwise. "Swamplandia!" is ultimately about the aching beauties of youth-the way life begins with such dumb sweetness, while the lessons that give it meaning lurk around each bend like terrifying gators in a mossy, fragrant swamp.

How to do well

Getting inside the mind

Making the right decisions

The Social Animal: The Hidden Sources of Love, Character and Achievement. By David Brooks. *Random House; 448 pages; $27.* Buy from Amazon.com

FORTY years ago Walter Mischel, an American psychologist, conducted a famous experiment. He left a series of four-year-olds alone in a room with a marshmallow on the table. He told them that they could eat the marshmallow at once, or wait until he came back and get two marshmallows. Recreations of the experiment on YouTube show what happens next. Some eat the marshmallow immediately. Others try all kinds of strategies to leave the tempting treat alone.

Nothing surprising there. The astonishing part was the way that the four-year-olds' ability to defer gratification was reflected over time in their lives. Those who waited longest scored higher in academic tests at school, were much less likely to drop out of university and earned substantially higher incomes than those who gobbled up the sweet straight away. Those who could not wait at all were far more likely, in later life, to have problems with drugs or alcohol.

In his fascinating study of the unconscious mind and its impact on our lives, David Brooks uses this story to illustrate how the conscious mind learns to subdue the unconscious. This is not a question of iron will, but about developing habits and strategies that trigger helpful processes in the unconscious, rather than unproductive ones. What matters is to learn to perceive property, people or situations in ways that reduce the temptation to lie, to steal or behave in a self-destructive way.

In building his argument, Mr Brooks, a columnist on the *New York Times*, uses as his framework the lives of two imaginary characters, Harold and Erica, whom he follows from cradle to grave. This deliberate homage to Jean-Jacques Rousseau's 1762 work, "Emile: or On Education", is not a success. Rousseau's book was banned and burned by angry readers. Harold and Erica are not that interesting, and they do get in the way of Mr Brooks's otherwise intriguing argument.

The author's aim is to show how recent research has illuminated the complex processes of the brain. "We have inherited an obsolete, shallow model of human nature," he argues. Study after study, many of them little known, show that people

take decisions about their jobs, relationships, actions and morals in ways that involve a complex interaction between the conscious and the unconscious mind. The most important decisions begin in the realm of the unconscious, although they are often influenced by the conscious.

The shaping of this delicate balance begins early in life: the children who were best at leaving their marshmallow on the plate tended to come from stable, organised homes. Culture and the community in which a child is raised help to build the way the conscious and unconscious intertwine. Mr Brooks recounts a survey of diplomats who failed to pay parking fines in New York. By far the worst non-payers came from countries where corruption is endemic: Egypt, Pakistan, Nigeria and so on. By contrast, diplomats from Sweden, Denmark, Japan, Israel, Norway and Canada had no unpaid fines at all. "Thousands of miles away from home," Mr Brooks writes, "diplomats still carried their domestic cultural norms inside their heads."

What does all this mean for public policy? Mr Brooks complains that policies too frequently rely on an overly simplistic, rationalist view of human nature. That may be true, but all too many daft policies rely on the collective reluctance of the voters to leave marshmallows uneaten on the table. More to the point, how can a country curb crime, create true equality and reduce the social and economic costs of bad decisions? Education systems exist mainly to build the rational mind, and yet the decisions that are most important in making people happy are the ones in which reason plays little or no part: the development of friendships and the choice of a spouse. Public policy has largely ignored this.

So Mr Brooks has done well to draw such vivid attention to the wide implications of the accumulated research on the mind and the triggers of human behaviour. But more books, preferably without Harold and Erica, remain to be written about the way societies should respond to what we now know.

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Foreign policy

The gospel according to Mark

Putting the world right

The Unfinished Global Revolution: The Pursuit of a New International Politics. By Mark Malloch Brown. *Penguin Press; 272 pages; $27.95. Allen Lane; pound25.* Buy from Amazon.com, Amazon.co.uk

THE clash that will really matter, contends Mark Malloch Brown in this admirable book, is between international co-operation and old-fashioned nationalism. With the world fast becoming a global bazaar, governments must commit themselves to an international framework of rules and institutions that would, he believes, make it a safer, fairer and less destructive place. Does the United Nations, where Lord Malloch-Brown spent much of his career, offer such a framework? Sadly no-unless, that is, countries can actually decide, by accepting the loss of certain of their own rights and privileges, to make it a less feeble and dysfunctional body.

People take jobs for odd reasons. But Lord Malloch-Brown's career seems to have followed a curiously logical pattern, each job-change marking a stage in his earnest search for an answer to the world's problems. In 1979, after a frustrating start battling bureaucracy at the United Nations (UN)-and a brief sideways stint as a political correspondent on this newspaper-he set off to help the refugees fleeing South-East Asia's awful wars. Humanitarian work for the UN, he concluded at the time, was a fine pursuit so long as it was kept as far away as could be from UN politics.

Instead of dealing with the causes of conflict, he worried that he was merely applying sticking plaster to its tragic consequences. Democracy, he believed, was the path to conflict resolution. So he transformed himself into a democratic mercenary, a counsellor to several would-be leaders, including Corazon Aquino who led the movement that toppled Ferdinand Marcos in the Philippines in 1986, and Mario Vargas Llosa in Peru, an inspired novelist who failed to make the presidency. After a while, he again became disillusioned, this time with the powers of democracy. Struggling countries, he recognised, needed economic security no less than political freedom. So he upped and joined first the World Bank and then its much poorer cousin, the UN Development Programme.

He shone as head of the UNDP which, unlike the World Bank, was considered by people in poor countries to be on their side. Because the agency was so short of money, he switched its priorities. Instead of supporting thousands of worthy but tiny projects he concentrated on providing practical advice to national decision- makers who could make a real difference to the ways their economies operated.

He was eventually brought back to politics by the wars with Afghanistan and Iraq. Involved in the UN's reconstruction attempts in both countries, he crossed to the top floor of its secretariat to become Kofi Annan's right-hand man. Lord Malloch-Brown depicts Mr Annan as a principled and (so far as possible) effective UN secretary-general. However, his opposition to the Iraq war brought him up against George Bush, who punished him by appointing John Bolton as America's ambassador to the UN. Mr Bolton, an arch-conservative who loathed what he saw as the UN's efforts to constrain America, unsurprisingly gets a rough ride in this book.

After corruption was once again exposed in UN ranks (not good, but limited to a handful of people), the Americans called on the organisation to reform itself. Few would disagree with that aim. But meaningful long-term reform will never come from internal tinkering with personnel and procedures that successive secretary-generals have had a shot at. Instead, the organisation needs a complete overhaul, starting with the Security Council, whose permanent members must share more power with emerging countries.

It was the glum realisation that this was not going to happen quickly (as much as his tussles with Mr Bolton) that seems to have persuaded the author to leave the UN and, newly ennobled, briefly join the British government under Gordon Brown. The prime minister proved a fountain of ideas for a common global approach. But he was a hopelessly unpopular spokesman: his international vision only irritated a hostile British public, hungry for homespun solutions to its problems.

And there's the rub. Most people-whether they be British voters, Mr Bolton or, for that matter, the rulers of the emerging world-are inveterate nationalists. Yet the author's conclusions remain cautiously optimistic. With every international agreement to reduce poverty, regulate finance, combat terrorism or protect the environment, we may be moving, tortoise-like, towards the global revolution he advocates so eloquently.

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America's most renowned architect

Restoring Wright

The difficult task of preserving Frank Lloyd Wright's Taliesin

The Wright stuff

A FLICKERING old film, on display at the Milwaukee Art Museum, shows Frank Lloyd Wright at home at Taliesin. There he is, pointing his cane over the Wisconsin valley that was his dominion, gathering heaps of flowers or lolling on a picnic blanket. There are his apprentices, who paid for the honour of working for him, diligently tilling the fields. And there is the house itself, beckoning.

Taliesin, which turns 100 this year, remains the purest expression of Wright's architectural philosophy. The Milwaukee Art Museum's exhibition marking the centennial is on until May 15th. Taliesin will also play host to an array of celebrations, but the most important challenge is the arduous work of helping Taliesin survive.

Wright built the house on a hill in the valley where he was raised. Taliesin, Welsh for "shining brow", was to be his home, studio and refuge. It also became the best symbol of what Wright called "organic architecture". "Taliesin", he wrote in his autobiography, "was to be an abstract combination of stone and wood as they naturally met in the aspect of the hills...The lines of the hills were the lines of the roofs, the slopes of the hills their slopes...Finished wood outside was the colour of grey tree-trunks in violet light."

For all its pastoral bliss, Taliesin endured the dramatic swings that characterised Wright's life. In 1914 a deranged servant set the house ablaze, killing seven, including Wright's mistress, Mamah Borthwick Cheney, and her two children. Another fire ravaged the house in 1925. Each time Wright rebuilt it. Even without the prompt of a disaster, he changed Taliesin again and again, always testing new ideas. It was less a finished product than an evolving piece of the hill.

Inevitably it has suffered in the decades since Wright's death in 1959. Taliesin's iterations and casual construction ensured unusual features. Heavy stone floors sit on wood beams. Gaps between windows and walls invite swarms of bats. Debris in the foundation, which is filled with rocks, freezes and expands in the cold, then thaws and shrinks, so that the house moves up and down each year, sighing with the seasons. In 1994 the National Trust for Historic Preservation declared Taliesin one of America's most endangered sites.

The Frank Lloyd Wright Foundation, which Wright created in 1940, still owns the house. But a non-profit organisation, Taliesin Preservation, Inc (TPI), is charged with restoring it. TPI was formed in 1991 on the recommendation of Wisconsin's governor. Progress has been slow, in part because Taliesin presents a particular conundrum. "I can't think of a more complicated challenge than trying to restore Frank Lloyd Wright's work in progress," says David De Long of the University of Pennsylvania and an adviser on another Wright house, Fallingwater.

It has not helped that TPI has little money. An $8m state loan has had to be forgiven twice-Taliesin attracted fewer paying visitors than expected (and far fewer than the nearby House on the Rock, home to the world's biggest indoor carousel). The late 1990s were particularly grim, thanks to mud slides and a massive oak that crashed into Wright's studio. TPI received a $1.14m federal grant in 1999, but much more money is needed: a master plan for restoration calls for over $30m. Such cash is unlikely to appear soon. TPI's most recent capital campaign was more than a decade ago.

Nevertheless, work is proceeding. "Nothing leaked this spring!" says Carol McChesney Johnson, TPI's president, triumphantly. TPI is restoring the house to its state in 1959, using sketches, interviews and photographs as guides. In the winter Taliesin's ochre walls and burned-red trim make striking bands against the snow. Jim Erickson, the estate manager, and his team of five are busy as ever. There are signs of progress. A heavy terrace no longer seems destined to drop on those below. The third Mrs Wright's bedroom is complete, at last. Most important, Mr Erickson is using reinforced concrete piers and beams to tether the house to the bedrock; otherwise Taliesin might slip down the hill. There is much more to be done.

Ms Johnson cannot say when restoration might be complete. Wright worked on Taliesin constantly. Now it seems that Taliesin's restorers will do the same.

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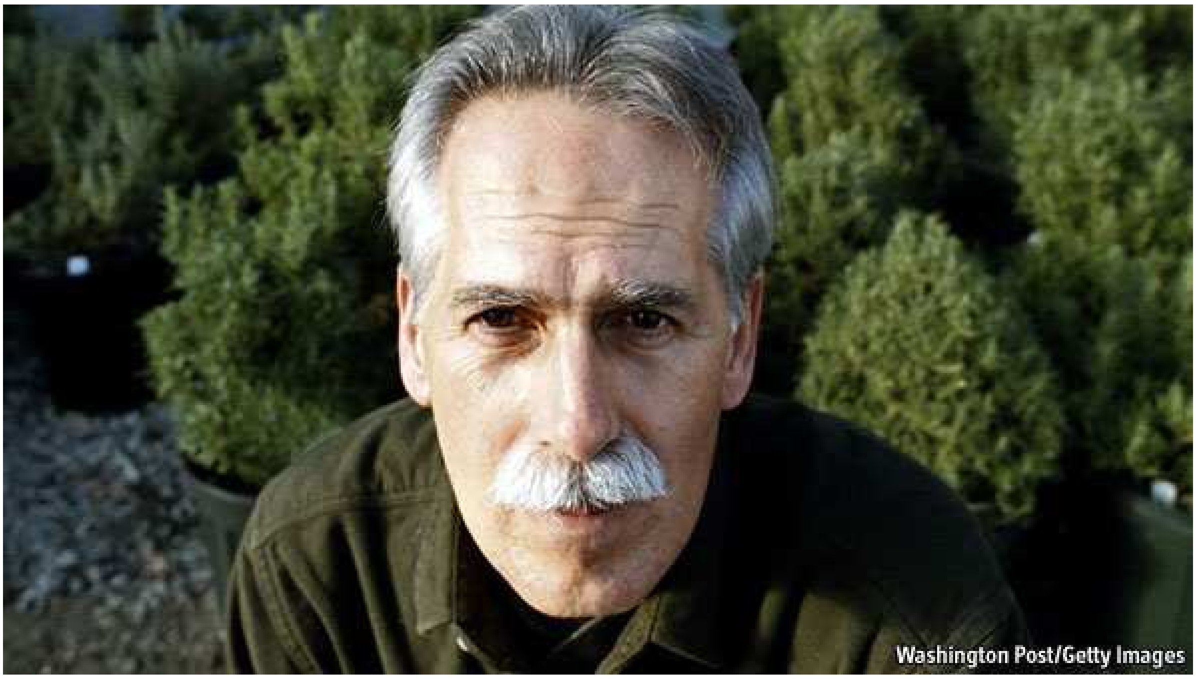
Tom DeBaggio

Thomas DeBaggio, herb-grower and Alzheimer's patient, died on February 21st, aged 69



AS THE smiling customer brought the potted plant to the cash register at DeBaggio Herbs in Chantilly, Virginia, Tom DeBaggio began to panic. The plant was small, with spiny, silvery leaves, woody stems and blue flowers. When rubbed between the fingers it gave off a warm, strong, piney smell, a bit like floor polish. But he did not know what it was. He fumbled for the tag, and when he couldn't find that, asked his wife Joyce what it could be. She told him, rosemary.

Yet he knew rosemary. He probably loved it more than any other plant in his nursery-though the basils and lavenders were right up there, too. He had once been called the best rosemaryologist in America for the work he had done, combing the world for new varieties or cultivating his own. "Gorizia", found in Italy, with lobelia-blue flowers; "Madalene Hill", which could take the worst soil and the coldest weather; "Lottie DeBaggio", straight and pale-flowered, named after his grandmother; "Joyce DeBaggio", with gold-edged leaves, named after his wife. The last was possibly his favourite, grown from one small, unusual, yellow branch. But now, in 1999, after 25 years in the nursery, he barely knew any of those familiar friends. Come to that, he was having trouble with the cash register, too.

On a beautiful spring day-weather that urged him into the garden, as if he wasn't there already potting and watering, planting and selling, for 16 hours a day-the doctor told him he had early-onset Alzheimer's Disease. He was 57. His first reaction was to rage and cry. His second was to go into his greenhouse, where the rosemary plants were in misty, lovely flower, and pull from somewhere the cruel adage that rosemary meant remembrance. But his third reaction was more positive, or desperate. He would try to chronicle for people what having Alzheimer's was like.

Before he had turned, in 1974, to herb-growing, he had been a journalist on the *Wilmington Independent* and the *Northern Virginia Sun*. He hadn't lasted long at either; his ideas were too left-wing. But there was still a novel in him, somewhere. He knew how to use words, and he realised that as long as he could articulate them, write them, recognise them and arrange them-all tasks that became increasingly difficult-he could give doctors an insight into a world few rationally entered, and almost no one spoke of. At the same time, he could try to pin down the thin, fast-fading shadow that was himself and his past. Otherwise, there would be nothing left.

In the four years after his diagnosis he gave four interviews to National Public Radio; appeared on Oprah Winfrey's TV talk show; was filmed for an HBO documentary; and produced two books, "Losing My Mind" and "When It Gets Dark". His interview answers often started confidently, with a rush of distant memories-his report on the first integrated high-school dinner in Virginia, the name of his editor, the exact time he handed in his copy-but foundered in tears when the words failed. He would cry, but then go on. The words were there somewhere, behind blurred window glass, in dark corners, as long as he could remember what he was searching for. That was the trouble: he would suddenly find himself driving his car on Route 50, or in the garden with watering can in hand, and have no idea why he was there.

The fishing place

He typed his books himself, though he might spend five minutes wondering how to spell "hour", or find each "B" replaced by a "P", or fail to recognise the word "wall", or what it meant. His pages of stuttering memories about favourite trees, or the lagging on the boiler-pipes in his house, would be interrupted by cries for help: *Sweet memory, the unreliable handmaiden of the past*. In 2000 "The Big Book of Herbs" came out, a project on which he had been working with botanist Arthur Tucker for ten years. He did not recall what it was when the box of shiny new volumes was delivered to his house. His own copy lay unread on the floor.

Surprisingly, in the turmoil of his anger, tears, frustration and regret, he found positive things. Inside his head he would see light shows: mostly green and blue mazes, sometimes yellow banners on the wall. These were the fires burning up his brain, but they were beautiful. Behind the mush of each day he could see westerns playing, the sort he had loved as a child. An ardent fisherman, he still took delight in fishing-gear catalogues, his pool of koi and his favourite trout-spot, Mossy Creek, where tall weeds stood right by the water. Yet fishing also made him think of trying to pluck words, with a rusty hook and no bait, out of the chaos of his mind. *I bob to the surface suddenly and wonder who I am.*

His original greenhouse, the one that had taken over most of his back yard as his business grew-from tomatoes in styrofoam cups, 25 cents each, to five acres of plants-still stood behind the house in Arlington. It was dilapidated, now the nursery had moved out to Chantilly, but he dreaded the idea of pulling it down. It had become his own memorial, the proof he had existed. A few rosemaries in pots were still inside it, and in 2003, unable to smell or name them, he would still water them-and then scream until he was hoarse his honking, barking Alzheimer's scream, where nobody could hear him.
